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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2004

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______

Commission file number 001-31922

TEMPUR-PEDIC INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**33-1022198** **(I.R.S. Employer Identification No.)**

1713 Jaggie Fox Way
Lexington, Kentucky 40511
(Address, including zip code, of registrant's principal executive offices)

Registrant's telephone number, including area code: (800) 878-8889

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes ☐ No ☒

The number of shares outstanding of the registrant's common stock as of August 2, 2004 was 97,720,046 shares.

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Special Note Regarding Forward-Looking Statements

This report contains “forward-looking statements” within the meaning of federal securities laws. These forward-looking statements include information concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, and other information that is not historical information. Many of these statements appear, in particular, under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” When used in this report, the words “estimates,” “expects,” “anticipates,” “projects,” “plans,” “intends,” “believes” and variations of such words or similar expressions are intended to identify forward-looking statements. All forward-looking statements, including, without limitation, our examination of historical operating trends, are based upon our current expectations and various assumptions. There can be no assurance that we will realize our expectations or that our beliefs will prove correct. When used in this report, the terms “Tempur-Pedic International” and the “Company” refer to Tempur-Pedic International Inc. only, and the terms “we,” “our,” “ours” and “us” refer to Tempur-Pedic International Inc. and its consolidated subsidiaries.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Important factors that could cause our actual results to differ materially from those expressed as forward-looking statements are set forth in this report, including under the heading “Risk Factors” under Item 2 of Part I. As described herein, such risks, uncertainties and other important factors include, among others:

- the level of competition in the mattress and pillow industries;
- our ability to effectively manage and sustain our growth;
- risks arising from having a new senior management team;
- our ability to maintain our return rates and warranty reserves;
- liability relating to our products;
- changes in, or failure to comply with, federal, state and/or local governmental regulations;
- our involvement in any government investigation and associated litigation or proceedings relating to any allegations of the possibility of price fixing in the mattress industry;
- our ability to enhance our existing products and to develop and market new products on a timely basis;
- risks arising from our international operations;
- our dependence on our significant customers;
- our ability to maintain our third party distributor arrangements;
- the efficiency and effectiveness of our advertising campaign and other marketing programs in building product and brand awareness and increasing sales;
- our ability to protect our patents and other intellectual property, as well as successfully defend against claims brought by our competitors under their patents and intellectual property;
- fluctuations in the cost of raw materials, the possible loss of suppliers and disruptions in the supply of our raw materials;
- fluctuations in exchange rates;
- unexpected equipment failures, delays in deliveries or catastrophic loss at our manufacturing facilities;
- our ability to maintain our labor relations;
- our ability to rely on the services of our senior management team;
- risks arising from our degree of leverage; and
- increase in interest expense.

There may be other factors that may cause our actual results to differ materially from the forward-looking statements.

All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this report and are expressly qualified in their entirety by the cautionary statements included in this report. Except as may be required by law, we undertake no obligation to publicly update or revise any of the forward-looking statements contained herein.

PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands except share and per share amounts)

	June 30, 2004 (Unaudited)	December 31, 2003
ASSETS		
Current Assets:		
Cash and cash equivalents	**$ 25,083**	$ 14,230
Accounts receivable, net	**75,177**	60,309
Inventories	**54,783**	58,276
Prepaid expenses and other current assets	**9,575**	6,937
Deferred income taxes	**5,768**	5,692
Total current assets	**170,386**	145,444
Property, plant and equipment, net	**116,978**	114,741
Goodwill	**208,856**	208,546
Other intangible assets, net	**77,993**	80,000
Restricted cash	**—**	60,243
Deferred financing and other non-current assets, net	**11,256**	11,375
Total assets	**$ 585,469**	$ 620,349
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	**$ 23,532**	$ 25,886
Accrued expenses and other	**53,915**	54,078
Current portion of long-term debt	**11,769**	10,496
Total current liabilities	**89,216**	90,460
Long-term debt	**299,748**	366,026
Deferred income taxes	**41,531**	39,049
Other non-current liabilities	**2,025**	2,105
Total liabilities	**432,520**	497,640
Commitments and contingencies (see notes)		
Stockholders' Equity:		
Common stock, $.01 par value, 300,000,000 shares authorized on June 30, 2004 and December 31, 2003; 97,675,555 and 97,317,669 shares issued and outstanding on June 30, 2004 and December 31, 2003, respectively	**977**	973
Additional paid in capital	**250,587**	249,946
Deferred stock compensation, net of amortization of $7,210 and $4,221 as of June 30, 2004 and December 31, 2003, respectively	**(5,946)**	(8,935)
Retained deficit	**(98,875)**	(127,630)
Accumulated other comprehensive income	**6,206**	8,355
Total stockholders' equity	**152,949**	122,709
Total liabilities and stockholders' equity	**$ 585,469**	$ 620,349

The accompanying notes to Condensed Consolidated Financial statements are an integral part of these statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands except share and per share amounts)

	Three Months Ended		Six Months Ended	
	June 30, 2004 (Unaudited)	June 30, 2003 (Unaudited)	June 30, 2004 (Unaudited)	June 30, 2003 (Unaudited)
Net sales	**$ 151,600**	$ 113,675	**$ 304,723**	$ 218,804
Cost of sales	**70,787**	51,140	**142,571**	98,635
Gross profit	**80,813**	62,535	**162,152**	120,169
Selling expenses	**31,653**	23,994	**66,608**	49,070
General and administrative expenses	**15,929**	11,302	**31,291**	21,203
Research and development expenses	**242**	138	**730**	414
Operating income	**32,989**	27,101	**63,523**	49,482
Other income (expense), net:				
Interest expense, net	**(5,551)**	(3,800)	**(11,645)**	(8,159)
Loss on extinguishment of debt	**—**	—	**(5,381)**	—
Other income (expense), net	**116**	455	**196**	(507)
Total other expense	**(5,435)**	(3,345)	**(16,830)**	(8,666)
Income before income taxes	**27,554**	23,756	**46,693**	40,816
Income tax provision	**10,608**	8,976	**17,977**	15,151
Net income	**$ 16,946**	$ 14,780	**$ 28,716**	$ 25,665
Basic earnings per share	**$ 0.17**	$ 1.89	**$ 0.29**	$ 3.28
Diluted earnings per share	**$ 0.16**	$ 0.16	**$ 0.28**	$ 0.27

The accompanying notes to Condensed Consolidated Financial Statements are an integral part of these statements.

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands except share and per share amounts)

	Six Months Ended	
	June 30, 2004 (Unaudited)	**June 30, 2003 (Unaudited)**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	**$ 28,716**	$ 25,665
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**10,976**	9,740
Amortization of deferred financing costs	**1,207**	1,198
Amortization of original issue discount	**—**	326
Stock based compensation amortization	**2,990**	163
Allowance for doubtful accounts	**1,871**	1,466
Deferred income taxes	**2,290**	(522)
Foreign currency adjustments	**(338)**	(3,322)
Loss (gain) on sale of equipment	**349**	(206)
Changes in operating assets and liabilities:		
Accounts receivable	**(17,571)**	(5,520)
Inventories	**2,923**	(16,208)
Prepaid expenses and other current assets	**(3,051)**	(1,383)
Accounts payable	**(1,783)**	4,234
Accrued expenses and other	**1,122**	7,328
Net cash provided by operating activities	**29,701**	22,959
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	**(13,796)**	(6,744)
Proceeds from sale of equipment	**64**	656
Net cash used by investing activities	**(13,732)**	(6,088)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from revolving credit facility	**20,512**	2,215
Repayments of revolving credit facility	**(26,670)**	(19,000)
Repayments of term loans	**(58,041)**	(5,149)
Repayments of other long term debt	**(159)**	(15)
Payments of deferred financing costs	**(1,083)**	—
Cash held in trust for repayment of Senior Subordinated Notes	**60,243**	—
Proceeds from issuance of common stock	**525**	—
Net cash used by financing activities	**(4,673)**	(21,949)
NET EFFECT OF EXCHANGE RATE CHANGES ON CASH	**(443)**	408
Increase (decrease) in cash and cash equivalents	**10,853**	(4,670)
CASH AND CASH EQUIVALENTS, beginning of period	**14,230**	12,654
CASH AND CASH EQUIVALENTS, end of period	**$ 25,083**	$ 7,984

The accompanying notes to Condensed Consolidated Financial Statements are an integral part of these statements.

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation and Description of Business—Tempur-Pedic International Inc. and subsidiaries (Tempur-Pedic International or the Company) is a US-based multinational corporation incorporated in Delaware. The Company manufactures, markets, and sells advanced visco-elastic foam products including pillows, mattresses and other related products. The Company manufactures essentially all of its products in Europe and in the United States. The Company has sales and distribution companies operating in the US, Europe and Asia Pacific. In addition, the Company has third party distributor arrangements in certain other countries where it does not have distribution companies. Currently, the Company sells its products in 60 countries and extends credit based on the creditworthiness of its customers.

The accompanying financial statements, prepared in accordance with the instructions to Form 10-Q and article 10 of Regulation S-X, are unaudited and do not include all the information and disclosures required by generally accepted accounting principles in the United States for complete financial statements. Accordingly, these accompanying unaudited financial statements should be read in conjunction with the consolidated financial statements of the Company and related footnotes for the year ended December 31, 2003 included in the Company's Form 10-K.

The results of operations for the interim periods are not necessarily indicative of results of operations for a full year. All necessary adjustments for a fair presentation of the results of operations for the interim periods have been made and are of a recurring nature unless otherwise disclosed herein.

On August 15, 2003, Tempur-Pedic, Inc. and Tempur Production USA, Inc. (Issuers) issued $150,000 aggregate principal amount of 10 $^{1}/_{4}$% Senior Subordinated Notes due 2010 (Senior Subordinated Notes). The Senior Subordinated Notes are unsecured senior subordinated indebtedness of the Issuers and are fully and unconditionally and jointly and severally guaranteed on an unsecured senior subordinated basis by the Issuers' ultimate parent, Tempur-Pedic International, and certain other subsidiaries of Tempur-Pedic International. On January 23, 2004, the Issuers redeemed an aggregate principal amount of $52,500 of outstanding Senior Subordinated Notes. The redemption price was 110.25% of the principal amount plus accrued interest, and the redemption was funded with a portion of the net proceeds from the initial public offering of the Company. The Company reflected the $5,381 redemption premium as a Loss on extinguishment of debt included in Other income (expense), net in the six months ended June 30, 2004.

On December 23, 2003, the Company closed its initial public offering of 21,562,500 shares of its common stock at an initial offering price of $14.00 per share. Of the 21,562,500 shares offered, the Company sold 6,250,000 shares and certain of the Company's stockholders sold a total of 15,312,500 shares, which included the exercise in full of the underwriters' overallotment option. The shares are traded on the New York Stock Exchange under the symbol "TPX". The net proceeds received by the Company were $81,813, before transaction costs of approximately $2,855. Total offering expenses were approximately $8,600, including underwriters' discount.

(b) *Reclassification*—Certain amounts have been reclassified to conform to the 2004 presentation.

(c) *Basis of Consolidation*—The Statements include the accounts of Tempur-Pedic International and its subsidiaries. All subsidiaries, directly or indirectly, are wholly owned. All intercompany balances and transactions have been eliminated.

(d) *Management's Use of Estimates*—The preparation of financial statements in conformity with accounting principles generally accepted in the United States (US GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(e) *Foreign Currency Translation*—Assets and liabilities of non-United States subsidiaries, whose functional currency is the local currency, are translated at period-end exchange rates. Income and expense items are translated at the weighted average rates of exchange prevailing during the period. The adjustment resulting from translating the financial statements of such foreign subsidiaries is included in Accumulated other comprehensive income, a component of Stockholders' equity. Foreign currency transaction gains and losses are reported in results of operations.

(f) *Financial Instruments and Hedging*—Derivative financial instruments are used within the normal course of business principally to manage foreign currency exchange rate risk. These instruments are generally short term in nature and are subject to fluctuations in foreign exchange rates and credit risk. Credit risk is managed through the selection of sound financial institutions as counterparties. The changes in fair market value of foreign exchange derivatives are recognized currently in Other comprehensive income.

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

(g) *Inventories*—Inventories are stated at the lower of cost or market, determined by the first-in, first-out method and consisted of the following:

	June 30, 2004	December 31, 2003
Finished goods	$ 35,238	$ 35,531
Work-in-process	5,488	6,555
Raw materials and supplies	14,057	16,190
	$ 54,783	$ 58,276

(h) *Long-Lived Assets*—Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of long-lived assets is assessed by a comparison of the carrying amount of the asset to the estimated future undiscounted net cash flows expected to be generated by the asset. If estimated future undiscounted net cash flows are less than the carrying amount of the asset or group of assets, the asset is considered impaired and expense is recorded in an amount required to reduce the carrying amount of the asset to its then fair value. Long-lived assets reflected in our Condensed Consolidated Balance Sheets consist of property, plant and equipment. Impairment of long-lived assets is governed by Statement of Financial Accounting Standards No. 144 (SFAS 144), “Accounting for the Impairment or Disposal of Long-Lived Assets.”

(i) *Goodwill and Other Intangible Assets*—The Company follows SFAS 142, “Goodwill and Other Intangible Assets” (SFAS 142). SFAS 142 requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. The Company performs an annual impairment test on all existing Goodwill and unamortized indefinite life intangible assets in the fourth quarter of each year. The Company performed the annual impairment test in the fourth quarter of 2003 to all existing Goodwill and unamortized indefinite life intangible assets and no impairment existed as of December 31, 2003. If facts and circumstances lead the Company’s management to believe that one of its assets may be impaired, the Company will evaluate the extent to which that cost is recoverable by comparing the future net undiscounted cash flows estimated to be associated with that asset to the asset’s carrying amount and write down that carrying amount to fair value to the extent necessary.

The following table summarizes information relating to the Company’s Other intangible assets:

		June 30, 2004			December 31, 2003		
	Useful Lives (years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Unamortized indefinite life intangible assets:							
Trademarks		$55,000	$ —	$55,000	$55,000	$ —	$55,000
Amortized intangible assets:							
Technology	10	$16,000	$ 2,667	$13,333	$16,000	$ 1,867	$14,133
Patents	5	5,048	1,668	3,380	5,000	1,167	3,833
Customer database	5	4,200	1,400	2,800	4,200	980	3,220
Foam formula	10	3,700	617	3,083	3,700	432	3,268
Non-competition agreements and other	1.5 - 5	2,231	1,834	397	2,044	1,498	546
Total		$86,179	$ 8,186	$77,993	$85,944	$ 5,944	$80,000

Amortization expense relating to intangible assets for Tempur-Pedic International was $975 and $1,270 for the three months ended June 30, 2004 and June 30, 2003, respectively. For the six months ended June 30, 2004 and June 30, 2003, amortization expense relating to intangible assets was $2,242 and $2,542, respectively.

The changes in the carrying amount of Goodwill for the six months ended June 30, 2004 are as follows:

Balance as of December 31, 2003	$208,546
Foreign currency translation adjustments	(62)
Other purchase accounting adjustments	372
Balance as of June 30, 2004	$208,856

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

In addition, Goodwill as of June 30, 2004 has been allocated to the Domestic and International segments as follows:

Domestic	$ 94,185
International	114,671
	$208,856

(j) *Accrued Sales Returns*—Estimated sales returns are provided at the time of sale based on historical sales returns. Tempur-Pedic International allows product returns ranging from 90 to 120 days following a sale. Accrued sales returns are included in Accrued expenses and other in the accompanying Condensed Consolidated Balance Sheets.

Tempur-Pedic International had the following activity for sales returns from December 31, 2003 to June 30, 2004:

Balance as of December 31, 2003	$ 5,456
Amounts accrued	18,858
Returns charged to accrual	(18,828)
Balance as of June 30, 2004	$ 5,486

(k) *Warranties*—The Company provides a 20-year warranty for US sales and a 15-year warranty for non-US sales on mattresses, each prorated for the last 10 years. In addition, a 2-year to 3-year warranty is provided on pillows. Estimated future obligations related to these products are provided by charges to operations in the period in which the related revenue is recognized. Warranties are included in Accrued expenses and other in the Condensed Consolidated Balance Sheets.

Tempur-Pedic International had the following activity for warranties from December 31, 2003 to June 30, 2004:

Balance as of December 31, 2003	$ 4,020
Amounts accrued	801
Warranties charged to accrual	(1,213)
Balance as of June 30, 2004	$ 3,608

(l) *Income Taxes*—Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. In accordance with SFAS 5, “Accounting for Contingencies”, the Company accrues for probable foreign and domestic tax obligations as required by facts and circumstances in the various regulatory environments.

At June 30, 2004, the Company had undistributed earnings of $63,050 from its foreign subsidiaries determined under US GAAP. In addition, the Company had undistributed earnings from periods ending prior to November 1, 2002 of $56,484 determined under US tax principles. No provisions have been made for US income taxes or foreign withholding taxes on these undistributed earnings as of June 30, 2004 as these earnings are considered indefinitely reinvested.

These undistributed earnings could become subject to US income taxes and foreign withholding taxes (subject to a reduction for foreign tax credits) if these undistributed earnings were remitted as dividends, loaned to the US parent company or a US subsidiary, or if the Company should sell its stock in the subsidiaries; however, the Company’s management does not currently expect these events to occur.

(m) *Revenue Recognition*—Sales of products are recognized when the products are shipped to customers and the risks and rewards of ownership are transferred. No collateral is required on sales made in the normal course of business. Allowance for doubtful accounts was $5,155 and $4,193 as of June 30, 2004 and December 31, 2003, respectively. Deposits made by customers are recorded as a liability and recognized as a sale when product is shipped. Tempur-Pedic International had $2,570 and $4,639 of deferred revenue included in Accrued expenses and other in the accompanying Condensed Consolidated Balance Sheets as of June 30, 2004 and December 31, 2003, respectively.

Tempur-Pedic International reflects all amounts billed to customers for shipping in Net sales and the costs incurred from shipping product in Cost of sales. Amounts included in Net sales for shipping and handling were approximately $4,940 and $4,528 for the three months ended June 30, 2004 and June 30, 2003, respectively. Amounts included in Net sales for shipping and handling were approximately $10,949 and $8,878 for the six months ended June 30, 2004 and June 30, 2003, respectively. Amounts included in Cost of sales for shipping and handling were approximately $13,524 and $10,888 for the three months ended June 30, 2004 and June 30, 2003, respectively. Amounts included in Cost of sales for shipping and handling were approximately $27,118 and $19,704 for the six months ended June 30, 2004 and June 30, 2003, respectively.

(In thousands except share and per share amounts)

(n) *Advertising Costs*—Tempur-Pedic International expenses advertising costs as incurred except for production costs and advance payments, which are deferred and expensed when advertisements run for the first time. Direct response prepayments are deferred and are amortized over the length of the program, generally four months. Advertising costs charged to expense were approximately $10,847 and $7,077 for the three months ended June 30, 2004 and June 30, 2003, respectively. For the six months ended June 30, 2004 and June 30, 2003, advertising costs charged to expense were approximately $33,515 and $23,411, respectively. Deferred advertising costs are included in Prepaid expenses and other current assets in the accompanying Condensed Consolidated Balance Sheets, and were approximately $2,953 and $4,473 as of June 30, 2004 and December 31, 2003, respectively.

(o) *Stock-Based Compensation*—The Company has adopted SFAS 123, “Accounting for Stock Based Compensation” (SFAS 123). In accordance with SFAS 123, the Company has elected to account for employee stock option issuances under Accounting Principles Board Opinion No. 25, “Accounting for Stock Issued to Employees” (APB 25). Under APB 25 no compensation expense is recognized in the statements of income for stock granted to employees and non-employee directors, if the exercise price at least equals the fair value of the underlying stock on the date of grant.

Stock options are granted under various stock compensation programs to employees. For purposes of pro forma disclosures in accordance with SFAS 123, the estimated fair value of the options is amortized to expense over the options’ vesting period.

Pro forma information in accordance with SFAS 123 for Tempur-Pedic International is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net income as Reported	$ 16,946	$ 14,780	$ 28,716	$ 25,665
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	1,490	105	2,990	163
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(2,365)	(211)	(4,713)	(306)
Pro forma Net income	$ 16,071	$ 14,674	$ 26,993	$ 25,522
Earnings per share:				
Basic as reported	$ 0.17	$ 1.89	$ 0.29	$ 3.28
Diluted as reported	$ 0.16	$ 0.16	$ 0.28	$ 0.27
Basic—Pro forma Net income	$ 0.16	$ 1.88	$ 0.28	$ 3.27
Diluted—Pro forma Net income	$ 0.16	$ 0.16	$ 0.26	$ 0.28

Certain options granted prior to the initial public offering have exercise prices that are less than the deemed market value of the underlying common stock at the date of grant. The unearned stock-based compensation will be amortized to compensation expense over the respective vesting term, based on “graded vesting” methodology. The Company has unearned stock-based compensation of $5,946 as of June 30, 2004, which has been reflected as a component of Stockholders’ Equity. The Company recorded $1,490 of compensation expense for the three months ended June 30, 2004, and $2,990 for the six months ended June 30, 2004. The future amortization of unearned stock-based compensation costs will be $2,181 for the remainder of 2004, $2,445 in 2005, $1,105 in 2006 and $214 in 2007.

(2) New Accounting Standard

In January 2003, the FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51” (FIN 46). FIN 46 requires an entity to consolidate a variable interest entity if it is designated as the primary beneficiary of that entity even if the entity does not have a majority of voting interests. A variable interest entity is generally defined as an entity where its equity is unable to finance its activities or where the owners of the entity lack the risk and rewards of ownership. The provisions of this statement apply at inception for any entity created after January 31, 2003. On October 10, 2003, the FASB issued

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

Staff Position (FSP) FIN 46-6, “Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities,” (the FSP). The FSP is a broad-based deferral of the effective date of FIN 46 for VIEs created or acquired prior to February 1, 2003. The Company adopted the provision of FIN 46 effective on March 31, 2004 and its adoption did not have an impact on the Condensed Consolidated Financial Statements.

(3) Supplemental Cash Flow Information

Cash payments for interest and income taxes were as follows for the three months and six months:

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Interest	$ 2,196	$ 3,570	$ 12,431	$ 6,149
Income taxes, net of refunds	$ 4,583	$ 3,034	$ 14,190	$ 6,825

Non-cash investing and financing activities have been excluded from the Condensed Consolidated Statements of Cash Flows.

(4) Property, Plant and Equipment

Property and equipment, net consisted of the following:

	June 30, 2004	December 31, 2003
Land and buildings	$ 58,503	$ 50,722
Machinery and equipment	71,932	55,060
Construction in progress	12,134	26,431
	142,569	132,213
Total accumulated depreciation	(25,591)	(17,472)
	$ 116,978	$ 114,741

(5) Long-term Debt

(a) *Senior Subordinated Notes*—The Senior Subordinated Notes are unsecured senior subordinated indebtedness of the Issuers and are guaranteed on an unsecured senior subordinated basis by the Company and certain of the Company’s subsidiaries. The Senior Subordinated Notes have no mandatory redemption or sinking fund requirements; however, they do provide for partial redemption at the Issuer’s option under certain circumstances prior to August 15, 2006 and full redemption at the Issuer’s option on or after August 15, 2007.

The Senior Subordinated Notes contain certain nonfinancial and financial covenants which include restrictions on: the declaration or payment of dividends and distributions; the purchase, redemption, acquisition or retirement of group equity interests; the payment, purchase, redemption, defeasance, acquisition or retirement of subordinated indebtedness; investments; the incurrence of indebtedness and issuance of preferred stock; the granting of liens; the making of loans and the transfer of properties and assets; mergers, consolidations or sale of assets; transactions with affiliates; the acquisition or creation of additional subsidiaries; and the sale and leaseback of assets. The Company was in compliance with all covenants as of June 30, 2004.

(b) *Secured Credit Financing*—On August 15, 2003, the Issuers, Tempur World Holding Company ApS, Dan-Foam ApS, certain Credit Parties as defined therein, General Electric Capital Corporation, Lehman Commercial Paper Inc., Nordea Bank Danmark A/S, GE European Leveraged Finance Limited, HSBC Bank PLC, the Lenders as defined therein, Lehman Brothers Inc. and GECC Capital Markets Group, Inc. entered into an amended and restated senior secured credit facility (Senior Credit Facility). The Senior Credit Facility has borrowing availability of $270,000 of senior secured US and European team loans and revolving credit facilities.

Borrowing availability under the US and European revolving credit facilities is subject to a US and European Borrowing Base, each as defined in the loan agreement for the Senior Credit Facility. At June 30, 2004, Tempur-Pedic International had unused availability under the Senior Credit Facility of approximately $26,509.

The aggregate amount of letters of credit outstanding under the US and European Facility was approximately $265 and $4,225 as of June 30, 2004, respectively.

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

The Senior Credit Facility subjects Tempur-Pedic International Inc. and its subsidiaries to certain financial covenants, including: minimum interest coverage ratio; minimum fixed charge coverage ratio; maximum leverage ratio; maximum senior leverage ratio; and a limitation on capital expenditures, in each case as defined. The Company was in compliance with all covenants as of June 30, 2004.

(c) *Long-term Debt*—Long-term debt for Tempur-Pedic International consisted of the following:

	June 30, 2004	December 31, 2003
US Term Loan A payable to a lender, interest at the IBOR plus margin (4.38% and 4.40% at June 30, 2004 and December 31, 2003, respectively), principal payments due quarterly through September 30, 2008 with a final payment on November 1, 2008	$ 9,562	$ 10,158
US Term Loan B payable to a lender, interest at the IBOR plus margin (4.59% and 4.64% at June 30, 2004 and December 31, 2003, respectively), principal payments due quarterly through June 30, 2009	133,650	134,325
European Term Loan A (USD Denominated) payable to a lender, interest at IBOR plus margin (4.39% and 4.40% at June 30, 2004 and December 31, 2003, respectively), principal payments due quarterly through September 30, 2008 with a final payment on November 1, 2008	35,568	37,784
European Term Loan A (EUR Denominated) payable to a lender, interest at IBOR plus margin (5.30% and 5.40% at June 30, 2004 and December 31, 2003, respectively), principal payments due quarterly through September 30, 2008 with a final payment on November 1, 2008	24,245	26,750
European Long-Term Revolving Credit Facility payable to a lender, interest at IBOR and index Rate plus margin (4.44% at December 31, 2003), commitment through and due November 1, 2008	—	15,250
US Long-Term Revolving Credit Facility payable to a lender, interest at IBOR and index Rate plus margin (4.26% at June 30, 2004), commitment through and due November 1, 2008	9,000	—
US Senior Subordinated Notes payable to institutional investors, interest at 10.25%, due August 15, 2010	97,500	150,000
Mortgages payable to a bank, secured by certain property, plant and equipment and other assets, bearing fixed interest at 4.40% to 5.10%	1,992	2,255
	311,517	376,522
Less: Current portion	11,769	10,496
Long-term debt	$ 299,748	$ 366,026

(6) Stockholders' Equity

(a) *Stock Split*—On December 23, 2003, the Company's Board of Directors declared a 525-for-one stock split, in the form of a stock dividend.

(b) *Initial Public Offering*—Effective with the Company's initial public offering on December 23, 2003, the authorized shares of capital stock were increased to 300 million shares of common stock and 10 million shares of preferred stock. Subject to preferences that may be applicable to any outstanding preferred stock of the Company, holders of the Company's common stock are entitled to receive ratably such dividends as may be declared from time to time by the board of directors out of funds legally available for that purpose. In the event of liquidation, dissolution, or winding up, the holders of the Company's common stock are entitled to share ratably in all assets remaining after payment of liabilities, subject to prior distribution rights of preferred stock of the Company, if any, then outstanding.

The Company is authorized to issue up to 10 million shares of preferred stock, $0.01 par value per share. The Board of Directors will be authorized, subject to any limitations prescribed by law, without further vote or action by the stockholders, to issue from time to time shares of preferred stock in one or more series. Each such series of preferred stock will have such number of shares, designations, preferences, voting powers, qualifications, and special or relative rights or privileges as determined by the Board of Directors, which may include, among others, dividend rights, voting rights, redemption and sinking fund provisions, liquidation preferences, conversion rights and preemptive rights.

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

(7) Stock based Compensation

(a) *Tempur-Pedic International 2003 Equity Incentive Plan*—The 2003 Equity Incentive Plan (the Plan) is administered by the Compensation Committee of the Board of Directors, which has the exclusive authority, including the power to determine eligibility to receive awards, the types and number of shares of stock subject to the awards, the price and timing of awards and the acceleration or waiver of any vesting, and performance of forfeiture restriction. The Compensation Committee, however, does not have the authority to waive any performance restrictions for performance-based awards.

Any of the Company's employees, non-employee directors, consultants and Company advisors, as determined by the Compensation Committee may be selected to participate in the Plan. The Plan provides for awards of stock options, stock appreciation rights, restricted stock and stock unit awards, performance shares, stock grants and performance based awards.

(b) *Tempur-Pedic International 2003 Stock Purchase Plan*—The 2003 Employee Stock Purchase Plan (ESPP) permits eligible employees to purchase up to certain limits as defined in the 2003 Employee Stock Purchase Plan of the Company's common stock annually over the course of two semi-annual offering periods at a price of no less than 85% of the price per share of the Company's common stock either at the beginning or the end of each six-month offering period, whichever is less. The Compensation Committee of the Board of Directors administers the ESPP. The Board of Directors may amend or terminate the ESPP. The ESPP complies with the requirements of Section 423 of the Internal Revenue Code. The Company may issue a maximum of 500,000 shares of its common stock under the ESPP.

(8) Comprehensive Income

Comprehensive income is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net Income	$ 16,946	$ 14,780	$ 28,716	$ 25,665
Other comprehensive income, net of tax:				
Financial instruments accounted for as hedges	(10)	(188)	(104)	(335)
Foreign currency translation	2,273	1,552	(2,045)	2,153
Comprehensive income	$ 19,209	$ 16,144	$ 26,567	$ 27,483

(9) Commitments and Contingencies

Litigation—The Company is party to various legal proceedings generally incidental to its business. Although the ultimate disposition of these proceedings is not presently determinable, management does not believe that adverse determinations in any or all of such proceedings will have a material adverse effect upon the financial condition, liquidity or results of operations of the Company.

(10) Income Taxes

The effective tax rate for Tempur-Pedic International for the three months and six months ended June 30, 2004 was 38.5%. Reconciling items between the federal statutory income tax rate of 35% and the effective tax rate include state income taxes, differences in US statutory rates and foreign tax rates, compensation expense associated with certain options granted prior to the initial public offering, and certain other permanent differences.

(11) Major Customers

Five customers accounted for approximately 13% and 22% of Tempur-Pedic International Net sales for the three months ended June 30, 2004 and June 30, 2003, respectively. These same customers also accounted for approximately 12% and 18% of accounts receivable as of June 30, 2004 and June 30, 2003, respectively. Five customers accounted for approximately 13% and 24% of Tempur-Pedic International's Net sales for the six months ended June 30, 2004 and June 30, 2003, respectively. The loss of one or more of these customers could have a material adverse effect on the Company.

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

(12) Earnings Per Share

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Numerator:				
Net income	$ 16,946	$ 14,780	$ 28,716	$ 25,665
Denominator:				
Denominator for basic earnings per share—weighted average shares	97,628,376	7,814,415	97,519,024	7,814,415
Effect of dilutive securities:				
Employee stock options	5,490,979	4,556,653	5,490,614	4,260,743
Warrants	—	4,458,306	—	4,458,305
Convertible preferred stock	—	76,893,416	—	76,893,416
Dilutive potential common shares	5,490,979	85,908,375	5,490,614	85,612,464
Denominator for diluted earnings per share—adjusted weighted average shares	103,119,355	93,722,790	103,009,638	93,426,879
Basic earnings per share	$ 0.17	$ 1.89	$ 0.29	$ 3.28
Diluted earnings per share	$ 0.16	$ 0.16	$ 0.28	$ 0.27

(13) Business Segment Information

Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available and is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and assessing performance. The Company operates in two business segments: Domestic and International. These reportable segments are strategic business units that are managed separately based on the fundamental differences in their operations. The Domestic segment consists of the United States manufacturing facility, whose customers include the United States distribution subsidiary and certain North American third party distributors. The International segment consists of the manufacturing facility in Denmark, whose customers include all of the distribution subsidiaries and third party distributors outside the Domestic segment. The Company evaluates segment performance based on Net sales and Operating income.

The following table summarizes segment information:

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Revenues from external customers:				
Corporate	$ —	$ —	$ —	$ —
Domestic	91,739	65,642	184,697	124,230
International	59,861	48,033	120,026	94,574
	$ 151,600	$ 113,675	$ 304,723	$ 218,804
Inter-Segment sales:				
Corporate	$ —	$ —	$ —	$ —
Domestic	—	—	—	—
International	(3,116)	(14,731)	(8,372)	(22,148)
Intercompany eliminations	3,116	14,731	8,372	22,148
	$ —	$ —	$ —	$ —
Operating income/(loss):				
Corporate	$ (4,396)	$ (1,788)	$ (8,647)	$ (3,203)
Domestic	21,670	15,656	41,360	26,364
International	15,715	13,233	30,810	26,321
	$ 32,989	$ 27,101	$ 63,523	$ 49,482
Depreciation and amortization (excluding stock-based compensation amortization):				
Corporate	$ 133	$ 450	$ 510	$ 870
Domestic	2,538	1,681	4,497	3,325
International	2,910	2,896	5,969	5,545
	$ 5,581	$ 5,027	$ 10,976	$ 9,740

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

The following table sets forth net sales by significant product group:

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Mattresses	$ 93,175	$ 61,823	$ 186,355	$ 118,658
Pillows	32,394	32,505	67,246	64,543
All other	26,031	19,347	51,122	35,603
	$ 151,600	$ 113,675	$ 304,723	$ 218,804

The Domestic segment purchases certain products produced by the Danish manufacturing facility included in the International segment and sell those products to Domestic segment customers. The profits from these sales, amounting to $752 and $4,107 for the three months ended June 30, 2004 and June 30, 2003, respectively, and $1,799 and $6,023 for the six months ended June 30, 2004 and June 30, 2003, respectively, are allocated to Operating income in the Domestic segment. Although these transactions are reported in the Domestic segment, the profit from these sales remain in the International segment for local statutory reporting purposes.

(14) Condensed Consolidating Financial Information

On August 15, 2003, the Issuers issued $150,000 aggregate principal amount of Senior Subordinated Notes. The Senior Subordinated Notes are unsecured senior subordinated indebtedness of the Issuers and are fully and unconditionally and jointly and severally guaranteed on an unsecured senior subordinated basis by the Issuers' ultimate parent, Tempur-Pedic International, and two intermediate parent corporations (referred to as the Combined Guarantor Parents) and all of Tempur-Pedic International's current and future domestic subsidiaries (referred to collectively as the Combined Guarantor Subsidiaries), other than the Issuers. The Issuers and subsidiary guarantors are indirectly 100% owned subsidiaries of the Combined Guarantor Parents and the subsidiary guarantors are 100% owned subsidiaries of the Issuers. The foreign subsidiaries (referred to as Combined Non-Guarantor Subsidiaries) represent the foreign operations of the Company and do not guarantee this debt. The following financial information presents condensed consolidating balance sheets for June 30, 2004 and December 31, 2003 and condensed consolidating statements of income for the three and six months ended June 30, 2004 and June 30, 2003 and statements of cash flows for the six months ended June 30, 2004 and June 30, 2003 for the Combined Guarantor Parents, Issuers and their Subsidiary Guarantors and Combined Non-Guarantor Subsidiaries. During the three months ended June 30, 2004 one of the Issuers established a new legal entity (Tempur-Pedic Retail, Inc.). Accordingly, Tempur-Pedic Retail, Inc. has been reflected as a Combined Guarantor Subsidiary.

Condensed Consolidating Balance Sheet
As of June 30, 2004
(Unaudited)

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Current assets	$ 1,400	$ 80,254	$ 3,185	$ 39,326	$ 125,183	$ (78,962)	$ 170,386
Property, plant and equipment, net	—	52,479	671	6,690	57,138	—	116,978
Other noncurrent assets	140,542	286,418	275,779	409	144,686	(549,729)	298,105
Total assets	141,942	419,151	279,635	46,425	327,007	(628,691)	585,469
Current liabilities	(1,619)	(3,533)	40,011	87,557	45,763	(78,963)	89,216
Noncurrent liabilities	32,000	493,603	170,721	102	203,569	(556,691)	343,304
Equity (deficit)	111,561	(70,919)	68,903	(41,234)	77,675	6,963	152,949
Total liabilities and equity (deficit)	$ 141,942	$ 419,151	$ 279,635	$ 46,425	$ 327,007	$ (628,691)	$ 585,469

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

Condensed Consolidating Balance Sheet
As of December 31, 2003

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Current assets	$ 4,884	$ 96,480	$ 11,793	$ 5,483	$ 121,599	$ (94,795)	$ 145,444
Property, plant and equipment, net	—	52,340	336	3,523	58,542	—	114,741
Other noncurrent assets	100,397	319,580	214,608	—	166,015	(440,436)	360,164
Total assets	105,281	468,400	226,737	9,006	346,156	(535,231)	620,349
Current liabilities	1,874	49,491	42,846	49,727	41,317	(94,795)	90,460
Noncurrent liabilities	32,000	463,217	170,898	109	245,873	(504,917)	407,180
Equity (deficit)	71,407	(44,308)	12,993	(40,830)	58,966	64,481	122,709
Total liabilities and equity (deficit)	$ 105,281	$ 468,400	$ 226,737	$ 9,006	$ 346,156	$ (535,231)	$ 620,349

Condensed Consolidating Statement of Income
For the Three Months Ended June 30, 2004
(Unaudited)

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	$ —	$ 1,707	$ —	$ 90,032	$ 62,977	$ (3,116)	$ 151,600
Cost of goods sold	—	(6,641)	(199)	53,646	27,097	(3,116)	70,787
Gross profit	—	8,348	199	36,386	35,880	—	80,813
Operating expenses	1,813	4,441	2,781	19,375	19,414	—	47,824
Operating income	(1,813)	3,907	(2,582)	17,011	16,466	—	32,989
Interest income (expense), net	—	(4,386)	(613)	5	(557)	—	(5,551)
Other income (loss)	—	15,679	9	(15,584)	12	—	116
Loss on extinguishment of debt	—	—	—	—	—	—	—
Income taxes	—	5,686	(1,034)	543	5,413	—	10,608
Net income (loss)	$ (1,813)	$ 9,514	$ (2,152)	$ 889	$ 10,508	$ —	$ 16,946

Condensed Consolidating Statement of Income
For the Six Months Ended June 30, 2004
(Unaudited)

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	$ —	$ 2,881	$ —	$ 181,816	$ 128,398	$ (8,372)	$ 304,723
Cost of goods sold	—	(14,657)	(400)	108,398	57,602	(8,372)	142,571
Gross profit	—	17,538	400	73,418	70,796	—	162,152
Operating expenses	3,626	8,357	5,421	43,037	38,188	—	98,629
Operating income	(3,626)	9,181	(5,021)	30,381	32,608	—	63,523
Interest income (expense), net	—	(9,153)	(1,194)	20	(1,318)	—	(11,645)
Other income (loss)	—	31,145	86	(31,050)	15	—	196
Loss on extinguishment of debt	—	5,381	—	—	—	—	5,381
Income taxes	—	9,206	(1,154)	(247)	10,172	—	17,977
Net income (loss)	$ (3,626)	$ 16,586	$ (4,975)	$ (402)	$ 21,133	$ —	$ 28,716

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TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 30, 2004
(Unaudited)

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net income (loss)	$ (3,626)	$ 16,586	$ (4,975)	$ (402)	$ 21,133	$ —	$ 28,716
Non-cash expenses	2,990	3,539	3,123	2,163	7,530	—	19,345
Changes in working capital	(3,834)	(27,194)	2,600	1,855	8,213	—	(18,360)
Net cash provided by operating activities	(4,470)	(7,069)	748	3,616	36,876	—	29,701
Net cash used for investing activities	—	(3,029)	(391)	(3,616)	(6,696)	—	(13,732)
Net cash provided by financing activities	525	15,472	(977)	—	(19,693)	—	(4,673)
Effect on exchange rate changes on cash	—	—	—	—	(443)	—	(443)
Net increase (decrease) in cash and cash equivalents	(3,945)	5,374	(620)	—	10,044	—	10,853
Cash and cash equivalents at beginning of the year	4,756	931	1,545	—	6,998	—	14,230
Cash and cash equivalents at end of period	$ 811	$ 6,305	$ 925	$ —	$ 17,042	$ —	$ 25,083

Condensed Consolidating Statement of Income
For the Three Months Ended June 30, 2003
(Unaudited)

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	$ —	$ 44,110	$ —	$ 21,533	$ 62,763	$ (14,731)	$ 113,675
Cost of goods sold	—	26,716	(142)	8,333	30,964	(14,731)	51,140
Gross profit	—	17,394	142	13,200	31,799	—	62,535
Operating expenses	113	9,318	1,817	9,727	14,459	—	35,434
Operating income	(113)	8,076	(1,675)	3,473	17,340	—	27,101
Interest expense, net	—	(509)	(2,061)	(24)	(1,206)	—	(3,800)
Other income (loss)	—	4,131	(590)	(4,102)	1,016	—	455
Income taxes	(5)	4,813	(1,967)	(249)	6,384	—	8,976
Net income (loss)	$ (108)	$ 6,885	$ (2,359)	$ (404)	$ 10,766	$ —	$ 14,780

TEMPUR-PEDIC INTERNATIONAL INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands except share and per share amounts)

Condensed Consolidating Statement of Income
For the Six Months Ended June 30, 2003
(Unaudited)

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net sales	$ —	$ 84,088	$ —	$ 40,142	$ 116,722	$ (22,148)	$ 218,804
Cost of goods sold	—	48,405	(268)	16,628	56,018	(22,148)	98,635
Gross profit	—	35,683	268	23,514	60,704	—	120,169
Operating expenses	175	18,089	3,296	20,767	28,360	—	70,687
Operating income	(175)	17,594	(3,028)	2,747	32,344	—	49,482
Interest expense, net	—	(1,148)	(5,236)	(39)	(1,736)	—	(8,159)
Other income (loss)	—	5,591	(709)	(5,553)	164	—	(507)
Income taxes	(5)	8,868	(3,773)	(1,082)	11,143	—	15,151
Net income (loss)	$ (170)	$ 13,169	$ (5,200)	$ (1,763)	$ 19,629	$ —	$ 25,665

Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 30, 2003
(Unaudited)

	Ultimate Parent	Combined Issuer Subsidiaries	Combined Guarantor Parents	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Consolidating Adjustments	Consolidated
Net income (loss)	$ (170)	$ 13,169	$ (5,200)	$ (1,763)	$ 19,629	$ —	$ 25,665
Non-cash expenses	175	2,722	(455)	223	6,178	—	8,843
Changes in working capital	(5)	(13,278)	5,992	1,792	(6,050)	—	(11,549)
Net cash provided by operating activities	—	2,613	337	252	19,757	—	22,959
Net cash used for investing activities	—	5,571	42	(252)	(11,449)	—	(6,088)
Net cash provided by financing activities	—	(8,800)	—	—	(13,149)	—	(21,949)
Effect on exchange rate changes on cash	—	—	—	—	408	—	408
Net increase (decrease) in cash and cash equivalents	—	(616)	379	—	(4,433)	—	(4,670)
Cash and cash equivalents at beginning of the year	—	654	609	—	11,391	—	12,654
Cash and cash equivalents at end of period	$ —	$ 38	$ 988	$ —	$ 6,958	$ —	$ 7,984

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the Condensed Consolidated Financial Statements and accompanying notes thereto included herein. The forward-looking statements in this discussion regarding the mattress and pillow industries, our expectations regarding our future performance, liquidity and capital resources and other non-historical statements in this discussion include numerous risks and uncertainties, as described under "Special Note Regarding Forward-Looking Statements" and "Risk Factors" and elsewhere in this quarterly report on form 10-Q. Our actual results may differ materially from those contained in any forward-looking statements. Except as may be required by law, we undertake no obligation to publicly update or revise any of the forward-looking statements contained herein.

Executive Overview

General — We are the market leading, vertically-integrated manufacturer, marketer and distributor of premium visco-elastic foam mattresses and pillows that we sell globally in 60 countries primarily under the Tempur® and Tempur-Pedic® brands. We believe our premium mattresses and pillows are more comfortable than standard bedding products because our proprietary visco-elastic foam is temperature sensitive, has a high density and conforms to the body to therapeutically align the neck and spine, thus reducing neck and lower back pain, two of the most common complaints about other sleep surfaces.

On December 23, 2003, the Company closed its initial public offering of 21,562,500 shares of its common stock at an initial offering price of $14.00 per share. Of the 21,562,500 shares offered, the Company sold 6,250,000 shares and certain of the Company's stockholders sold a total of 15,312,500 shares, which included the exercise in full of the underwriters' overallotment option. The shares are traded on the New York Stock Exchange under the symbol "TPX". For purposes of this Management's Discussion and Analysis of Financial Condition and Results of Operations, the terms "we," "our," "ours" and "us" refer to Tempur-Pedic International Inc. and its consolidated subsidiaries.

Business Segment Information — We operate in two business segments: Domestic and International. These reportable segments are strategic business units that are managed separately.

The Domestic segment consists of our United States manufacturing facility, which commenced operations in July 2001 and whose customers include our United States distribution subsidiary and certain North American third party distributors. The International segment consists of our manufacturing facility in Denmark, whose customers include all of our distribution subsidiaries and third party distributors outside the Domestic segment. We evaluate segment performance based on Net sales and Operating income.

Key Operating Highlights

Our Net income and diluted earnings per share were $16.9 million and $0.16 per share with 103.1 million diluted weighted average shares outstanding for the three months ended June 30, 2004, compared to $14.8 million or $0.16 per share with 93.7 million diluted weighted average shares outstanding for the three months ended June 30, 2003. For the six months ended June 30, 2004 and June 30, 2003, Net income and diluted earnings per share were $28.7 million and $0.28 per share with 103.0 million diluted weighted average shares outstanding, and $25.7 million and $0.27 per share with 93.4 million diluted weighted average shares outstanding, respectively. In the second quarter of 2004, the Company recorded $1.5 million of compensation expense associated with certain stock options granted prior to the initial public offering. For the six months ended June 30, 2004, Net income includes non-cash stock-based compensation of $3.0 million and loss on debt extinguishment of $3.3 million, net of tax, relating to the redemption of $52.5 million aggregate principal amount of the outstanding 10 $^{1}/_{4}$% Senior Subordinated Notes.

Net sales for the three months ended June 30, 2004 were $151.6 million as compared to $113.7 million for the three months ended June 30, 2003, an increase of $37.9 million, or 33%. This increase was primarily attributable to our growth in the Retail channel of our Domestic segment, which increased $27.0 million, which represents 71% of our total Net sales growth. In addition, our International segment's Retail channel grew $10.6 million, which represents 28% of our total Net sales growth. Net sales for the six months ended June 30, 2004 were $304.7 million as compared to $218.8 million for the six months ended June 30, 2003, an increase of $85.9 million, or 39%. This increase was also primarily attributable to our growth in the Retail channel of our Domestic segment, which increased $55.1 million, which represents 64% of our total Net sales growth. In addition, our International segment's Retail channel grew $20.2 million, which represents 24% of our total Net sales growth.

Operating income for the three months ended June 30, 2004 was $33.0 million as compared to $27.1 million for the three months ended June 30, 2003, an increase of $5.9 million, or 22%. Operating income as a percentage of Net sales was 22% for the three months ended June 30, 2004 and 24% for the three months ended June 30, 2003. For the six months ended June 30, 2004 and June 30, 2003, Operating income was $63.5 million and $49.5 million, respectively. This represents an increase of $14.0 million, or

28%. Operating income as a percentage of Net sales was 21% for the six months ended June 30, 2004 and 23% for the six months ended June 30, 2003. Operating income as a percentage of Net sales reflects the effects of product mix, increased spending on information technology, and implementation costs in 2004 to comply with the requirements of the Sarbanes-Oxley Act of 2002.

A summary of key operating results follows:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2004	2003	Chg%	2004	2003	Chg%
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Net sales	$ 151.6	$ 113.7	33%	$ 304.7	$ 218.8	39%
Operating income	33.0	27.1	22%	63.5	49.5	28%
Net income	$ 16.9	14.8	14%	$ 28.7	25.7	12%
Weighted average shares, diluted	103,119,355	93,722,790		103,009,638	93,426,879	
Earnings per share, diluted	$ 0.16	$ 0.16		$ 0.28	$ 0.27	

Business Risks and Opportunities

Managing rapid growth – We have grown rapidly, with our net sales increasing from approximately $221.5 million for the year ended December 31, 2001 to $479.1 million for the year ended December 31, 2003 and to $304.7 million for the six months ended June 30, 2004. Our growth has placed, and will continue to place, a strain on our management, production, product distribution network, information systems and other resources. In response to these challenges, management has continued to invest in increased production capacity, enhance operating and financial infrastructure and systems and to continue to expand the employee base in our operations. Our expenditures for advertising and other marketing related activities are made as advertising rates are favorable to us and as the continued growth in the business allows us the ability to invest in building our brand.

Competition — Participants in the mattress and pillow industries compete primarily on price, quality, brand name recognition, product availability and product performance. We compete with a number of different types of mattress alternatives, including standard innerspring mattresses, other foam mattresses, waterbeds, futons, air beds and other air-supported mattresses. These alternative products are sold through a variety of channels, including furniture stores, specialty bedding stores, department stores, mass merchants, wholesale clubs, telemarketing programs, television infomercials and catalogs.

Our largest competitors have significant financial, marketing and manufacturing resources and strong brand name recognition, and sell their products through broad and well established distribution channels. Additionally, management believes that a number of our significant competitors now offer foam mattress products similar to our visco-elastic foam mattresses and pillows. The Company is susceptible to competition from lower priced product offerings. We provide strong channel profits to our retailers and distributors which management believes will continue to provide an attractive business model for our retailers and discourage them from carrying competing lower priced products.

Financial leverage — As of June 30, 2004, the book value of our debt was $311.5 million, and our stockholders' equity was $152.9 million. Higher financial leverage makes us more vulnerable to general adverse competitive, economic and industry conditions. Management believes that operating margins combined with the inherent operating leverage in the business will enable us to continue de-leveraging the business in a manner consistent with historical experience. There can be no assurance, however, that our business will generate sufficient cash flow from operations or that future borrowings will be available under our senior credit facilities, or otherwise, to enable us to continue to de-leverage the business.

Critical Accounting Policies and Estimates

Our management is responsible for our financial statements and has evaluated the accounting policies to be used in their preparation. Our management believes these policies are reasonable and appropriate. The following discussion identifies those accounting policies that we believe will be critical in the preparation of our financial statements, the judgments and uncertainties affecting the application of those policies and the possibility that materially different amounts will be reported under different conditions or using different assumptions.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that the management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of commitments and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

Our estimates of sales returns are a critical component of our revenue recognition. We recognize sales, net of estimated returns, when we ship our products to customers and the risks and rewards of ownership are transferred to them. Estimated sales returns are provided at the time of sale, based on our level of historical sales returns. We allow returns for up to 120 days following a sale, depending on the channel and promotion. Our level of sales returns differs by channel, with our direct channel typically experiencing the highest rate of returns. Our level of returns has been generally stable over the last five years and consistent with our estimates.

Warranties

Cost of sales includes estimated costs to service warranty claims of our customers. Our estimate is based on our historical claims experience and extensive product testing that we perform from time to time. We provide a 20-year warranty for United States sales and a 15-year warranty for non-United States sales on mattresses, each prorated for the last 10 years. Because our products have not been in use by our customers for the full warranty period, we rely on the combination of historical experience and external product testing for the development of our estimate for warranty claims. Our estimate of warranty claims could be adversely affected if our historical experience ultimately proves to be greater than the performance of the product in our product testing. We also provide 2-year to 3-year warranties on pillows. Estimated future obligations related to these products are provided by charges to operations in the period in which the related revenue is recognized. Our estimated obligation for warranty claims as of June 30, 2004 was $3.6 million. As of June 30, 2003, our estimated obligation for warranty claims was $3.3 million.

Impairment of Goodwill, Intangibles and Long-Lived Assets

Goodwill reflected in our Condensed Consolidated Balance Sheets consist of the purchase price from the Tempur acquisition (the Company acquired Tempur World, Inc. in 2002) in excess of the estimated fair values of identifiable net assets as of the date of the Tempur acquisition. Intangibles consist of tradenames for various brands under which our products are sold. Other intangibles include our customer database for our direct channel, process technology and the formulation of our visco-elastic foam.

We follow SFAS 142, “Goodwill and Other Intangible Assets” (SFAS 142). SFAS 142 requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. We perform an annual impairment test on all Goodwill and unamortized indefinite life intangible assets in the fourth quarter of each year. We performed the annual impairment test in the fourth quarter of 2003 to all existing goodwill and unamortized indefinite life intangible assets and no impairment existed as of December 31, 2003. If facts and circumstances lead our management to believe that one of our assets may be impaired, we will evaluate the extent to which that cost is recoverable by comparing the future undiscounted cash flows estimated to be associated with that asset to the asset’s carrying amount and write down that carrying amount to fair value to the extent necessary.

Estimates of fair value involve highly subjective judgments on the part of management, including the amounts of cash flows to be received, their estimated duration, and perceived risk as reflected in selected discount rates. In some cases, cash flows may be required to be estimated without the benefit of historical data, although historical data will be used where available. Although we believe our estimates and judgments are reasonable, different assumptions and judgments could result in different impairment, if any, of some or all of our recorded goodwill and indefinite-lived intangibles of $286.8 million as of June 30, 2004.

Long-lived assets reflected in our Condensed Consolidated Balance Sheets consist of property, plant and equipment. Impairment of long-lived assets is governed by Statement of Financial Accounting Standards No. 144 (SFAS 144), “Accounting for the Impairment or Disposal of Long-Lived Assets.”

SFAS 144 requires that whenever events or circumstances indicate that we may not be able to recover the net book value of our productive assets through future cash flows, an assessment must be performed of expected future cash flows, and undiscounted estimated future cash flows must be compared to the net book value of these productive assets to determine if impairment is indicated. Impaired assets are written down to their estimated fair value by recording an impairment charge to earnings. SFAS 144 provides that fair values may be estimated using discounted cash flow analysis or quoted market prices, together with other available information, to estimate fair values. We primarily use discounted cash flow analysis to estimate the fair value of productive assets when events or circumstances indicate that we may not be able to recover our net book values.

The application of SFAS 144 requires the exercise of significant judgment and the preparation of numerous significant estimates. Although we believe that our estimates of cash flows in our application of SFAS 144 are reasonable, and based upon all available information, including historical cash flow data about the prior use of our assets, such estimates nevertheless require substantial judgments and are based upon material assumptions about future events.

Income Tax Accounting

Income taxes are accounted for in accordance with Statement of Financial Accounting Standards No. 109 (SFAS 109), "Accounting for Income Taxes." SFAS 109 requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities. These deferred taxes are measured by applying the provisions of tax laws in effect at the balance sheet date.

We recognize deferred tax assets in our balance sheet, and these deferred tax assets typically represent items deducted currently in the financial statements that will be deducted in future periods in tax returns. In accordance with SFAS 109, a valuation allowance is recorded against these deferred tax assets to reduce the total deferred tax assets to an amount that will, more likely than not, be realized in future periods. The valuation allowance is based, in part, on our estimate of future taxable income, the expected utilization of tax loss carryforwards, both domestic and foreign, and the expiration dates of tax loss carryforwards. Significant assumptions are used in developing the analysis of future taxable income for purposes of determining the valuation allowance for deferred tax assets, which, in our opinion, are reasonable under the circumstances.

At June 30, 2004, the Company had undistributed earnings of $63.1 million from its foreign subsidiaries determined under US GAAP. In addition, the Company had undistributed earnings from periods ending prior to November 1, 2002 of $56.5 million determined under US tax principles. No provisions have been made for US income taxes or foreign withholding taxes on these undistributed earnings as of June 30, 2004 as these earnings are considered indefinitely reinvested.

These undistributed earnings could become subject to US income taxes and foreign withholding taxes (subject to a reduction for foreign tax credits) if these undistributed earnings were remitted as dividends, loaned to Tempur-Pedic International or a US subsidiary, or if the Company should sell its stock in the subsidiaries; however, our management does not currently expect these events to occur.

Stock-Based Compensation

We account for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and comply with the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." Several companies recently elected to change their accounting policies and record the fair value of options as an expense. We currently are not required to record stock-based compensation charges if the employee stock option exercise price or restricted stock purchase price equals or exceeds the deemed fair value of the Company's common stock at the grant date.

In addition, we understand that discussions of potential changes to APB 25 and SFAS 123 standards are ongoing and the parties responsible for authoritative guidance in this area may require changes to the applicable accounting standards. If we had estimated the fair value of the options on the date of grant using a minimum value pricing model and then amortized this estimated fair value over the vesting period of the options, our net income (loss) would have been adversely affected.

Certain options granted prior to the initial public offering have exercise prices that are less than the deemed market value of the underlying common stock at the date of grant. The unearned stock-based compensation will be amortized to compensation expense over the respective vesting term, based on the "graded vesting" methodology. We have recorded deferred stock compensation of $7.2 million as of June 30, 2004, which is reflected as a component of Stockholders' equity in the accompanying Condensed Consolidated Balance Sheet. We have recorded $1.5 million and $3.0 million of compensation expense for the quarter ended June 30, 2004 and six months ended June 30, 2004, respectively. The future amortization of unearned stock-based compensation costs will be $2.2 million for the remainder of 2004, $2.4 million in 2005, $1.1 million in 2006 and $0.2 million in 2007.

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Results of Operations

The following table sets forth the various components of our Condensed Consolidated Statements of Income:

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net sales	$ 151.6	$ 113.7	$ 304.7	$ 218.8
Cost of sales	70.8	51.1	142.5	98.6
Gross profit	80.8	62.6	162.2	120.2
Selling expenses	31.7	24.0	66.6	49.1
General and administrative and other	16.1	11.5	32.1	21.6
Operating income	33.0	27.1	63.5	49.5
Interest expense, net	(5.5)	(3.8)	(11.6)	(8.2)
Loss on extinguishment of debt	—	—	(5.4)	—
Other income/(expense), net	0.1	0.5	0.2	(0.5)
Income before income taxes	27.6	23.8	46.7	40.8
Income tax provision	10.7	9.0	18.0	15.1
Net income	$ 16.9	$ 14.8	$ 28.7	$ 25.7

The following table sets forth the various components of our Condensed Consolidated Statements of Income, expressed as a percentage of net sales:

	Three Months Ended		Six Months Ended	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Net sales	100%	100%	100%	100%
Cost of sales	47	45	47	45
Gross profit	53	55	53	55
Selling expenses	21	21	22	22
General and administrative and other	10	10	10	10
Operating income	22	24	21	23
Interest expense, net	(4)	(3)	(4)	(4)
Loss on extinguishment of debt	—	—	(2)	—
Other income/(expense), net	—	—	—	—
Income before income taxes	18	21	15	19
Income tax provision	7	8	6	7
Net income	11%	13%	9%	12%

We generate sales through four distribution channels: retail, direct, healthcare and third party. The retail channel sells to furniture, specialty and department stores. The direct channel sells directly to consumers. The healthcare channel sells to hospitals, nursing homes, healthcare professionals and medical retailers. The third party channel sells to distributors in countries where we do not operate our own distribution. The following table sets forth net sales information, by channel and by segment, for the periods indicated:

	Consolidated		Domestic		International	
			Three Months Ended			
($ in millions)	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Retail	$ 106.1	$ 68.5	$ 68.5	$ 41.5	$ 37.6	$ 27.0
Direct	22.8	23.9	18.9	20.6	3.9	3.3
Healthcare	10.4	9.8	2.6	2.3	7.8	7.5
Third Party	12.3	11.5	1.7	1.3	10.6	10.2
	$ 151.6	$ 113.7	$ 91.7	$ 65.7	$ 59.9	$ 48.0
Domestic	$ 91.7	$ 65.7				
International	59.9	48.0				
	$ 151.6	$ 113.7				

($ in millions)	Consolidated		Domestic		International	
	Six Months Ended					
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
Retail	$ 210.8	$ 135.4	$ 136.0	$ 80.9	$ 74.8	$ 54.6
Direct	47.8	43.0	40.4	37.0	7.4	6.0
Healthcare	22.2	21.1	5.4	4.3	16.7	16.8
Third Party	23.9	19.3	2.9	2.0	21.1	17.2
	$ 304.7	$ 218.8	$ 184.7	$ 124.2	$ 120.0	$ 94.6
Domestic	$ 184.7	$ 124.2				
International	120.0	94.6				
	$ 304.7	$ 218.8				

Our sales and gross margins are influenced by several factors including changes in product mix, sales channel mix and geography mix. The largest growth in our business in the last year continues to be in the Domestic retail sales channel. The retail channel contributed 70% of our revenue in the second quarter of 2004 compared to only 60% in the second quarter of 2003. Our retail channel mix affects gross margin because we sell into the retail channel at wholesale prices versus the full MSRP that we receive in our direct channel. Our growth strategy domestically continues to build around increasing the retail presence for our products and building brand awareness in consumers through our advertising campaigns.

As of June 30, 2004 our products were offered in approximately 3,600 furniture retail stores domestically, representing an increase in the second quarter of approximately 500 stores. We are also in approximately 1,500 specialty stores in the U.S. In addition, in the second quarter we added 170 retail stores internationally in the markets served directly by the Company.

Three Months Ended June 30, 2004 Compared with Three Months Ended June 30, 2003

Net Sales. Net sales for the three months ended June 30, 2004 were $151.6 million as compared to $113.7 million for the three months ended June 30, 2003, an increase of $37.9 million, or 33%. The increase in Net sales was attributable to growth in our Domestic Net sales to $91.7 million for the three months ended June 30, 2004 as compared to $65.7 million for the three months ended June 30, 2003, an increase of $26.0 million, or 40%, and an increase in our International Net sales to $59.9 million for the three months ended June 30, 2004 as compared to $48.0 million for the three months ended June 30, 2003, an increase of $11.9 million, or 25%. The growth in our Domestic Net sales was attributable primarily to an increase in Net sales in our Retail channel of $27.0 million, or 65%. During the three months ended June 30, 2004 we added distribution to approximately 500 furniture retail stores in the US bringing the total US furniture retail stores to approximately 3,600. Growth in our International Net sales was attributable primarily to growth in the Retail channel of $10.6 million, or 39%. Internationally, we added placements in approximately 170 stores. Our recently introduced mattress in the US market, the Celebrity Mattress, represented 13% of Domestic net mattress sales across all channels for the three months ended June 30, 2004.

Cost of Sales. Cost of sales includes the cost of raw material purchases, manufacturing costs and distribution costs associated with the production and sale of products to our customers. The cost of delivering our products to customers is also included in Cost of sales. Cost of sales increased to $70.8 million for the three months ended June 30, 2004 as compared to $51.1 million for the three months ended June 30, 2003, an increase of $19.7 million, or 39%. The Cost of sales as a percentage of Net sales for the three months ended June 30, 2004 and June 30, 2003 was 47% and 45%, respectively. Cost of sales as a percentage of Net sales increased primarily due to the changing channel mix toward the Retail channel. Our Retail channel contributed approximately 70% of our net sales in the three months ended June 30, 2004, compared to 60% in the three months ended June 30, 2003. The Retail channel mix affects the percentage of Cost of sales to Net sales as we are selling into the Retail channel at wholesale prices versus the full MSRP that we receive in the Direct channel. Our Domestic Cost of sales increased to $46.8 million for the three months ended June 30, 2004 as compared to $34.9 million for the three months ended June 30, 2003, an increase of $11.9 million, or 34%. Our International Cost of sales decreased to $27.1 million for the three months ended June 30, 2004 as compared to $31.0 million for the three months ended June 30, 2003, a decrease of $3.9 million, or 13%, excluding eliminations for sales from the International segment to the Domestic segment.

Selling Expenses. Selling expenses include advertising and media production associated with our Direct channel, other marketing materials such as catalogs, brochures, videos, product samples, direct customer mailings and point of purchase materials, and sales force compensation and customer service. Selling expenses increased to $31.7 million for the three months ended June 30, 2004 as compared to $24.0 million for the three months ended June 30, 2003, an increase of $7.7 million, or 32%. Selling expenses as a percentage of Net sales was 21% during the three months ended June 30, 2004 and the three months ended June 30, 2003. The increase in the dollar amount of Selling expenses was due to additional spending on advertising, sales compensation and point of purchase materials. Selling expenses as a percentage of Net sales are affected by our channel sales mix and the types of advertising and promotions run during the period.

General and Administrative and Other. General and administrative and other expenses include management salaries, information technology, professional fees, depreciation of furniture and fixtures, leasehold improvements and computer equipment, expenses for finance, accounting, human resources and other administrative functions, and research and development costs associated with our new product developments. General and administrative and other expenses increased to $16.1 million for the three months ended June 30, 2004 as compared to $11.5 million for the three months ended June 30, 2003, an increase of $4.6 million, or 40%. The increase was due to additional spending on corporate overhead expenses, including information technology and professional services. General and administrative expenses for the three months ended June 30, 2004 included approximately $1.2 million in costs associated with our implementation of the requirements of Sarbanes-Oxley Section 404.

Certain stock options granted during the year prior to the initial public offering have exercise prices that are less than the deemed market value of the underlying common stock at the date of grant. We recorded $1.5 million of compensation expense included in General and administrative expenses in the accompanying Condensed Consolidated Statements of Income for the three months ended June 30, 2004.

Interest Expense, Net. Interest expense, net includes the interest costs associated with our debt facilities and the amortization of deferred financing costs related to those facilities. Interest expense, net increased to $5.5 million for the three months ended June 30, 2004 as compared to $3.8 million for the three months ended June 30, 2003, an increase of $1.7 million. This increase was due to higher average debt levels. In 2003, we entered into an interest rate cap agreement that effectively capped $60.0 million of our floating-rate debt at an interest rate of 5% plus applicable margin through March 2006. We are required under our existing credit agreements to hedge at least $60.0 million of our floating rate senior term debt.

Income Tax Provision. Our effective tax rate for the three months ended June 30, 2004 was approximately 38.5% as compared to 37.8% for the three months ended June 30, 2003. The increase in our effective tax rate for the three months ended June 30, 2004 was due to an increase in non-deductible compensation expense associated with certain options granted prior to the initial public offering, state income taxes and subpart F type income along with reductions in the amount of valuation allowances recorded against foreign net operating losses and an increased benefit from charitable contributions.

Six Months Ended June 30, 2004 Compared with Six Months Ended June 30, 2003

Net Sales. Net sales for the six months ended June 30, 2004 were $304.7 million as compared to $218.8 million for the six months ended June 30, 2003, an increase of $85.9 million, or 39%. This increase is primarily attributable to a 56% growth in our Retail channel, which increased to $210.8 million for the six months ended June 30, 2004 from $135.4 million for the six months ended June 30, 2003. Our Domestic Net sales for the six months ended June 30, 2004 were $184.7 million as compared to $124.2 million for the six months ended June 30, 2003. This represents an increase of $60.5 million, or 49%. The growth in our Domestic Net sales was attributable primarily to an increase in Net sales in our Retail channel of $55.1 million, or 68%. During the six months ended June 30, 2004 we added distribution to approximately 900 furniture retail stores in the US bringing the total US furniture retail stores to approximately 3,600. Our International Net sales for the six months ended June 30, 2004 were $120.0 million, and were $94.6 million for the six months ended June 30, 2003. This represents an increase of $25.4 million, or 27%. The growth in our International Net sales was attributable primarily to growth in the Retail channel of $20.2 million, or 37%.

Cost of Sales. Cost of sales increased to $142.5 million for the six months ended June 30, 2004 as compared to $98.6 million for the six months ended June 30, 2003, an increase of $43.9 million, or 45%. The Cost of sales as a percentage of Net sales for the six months ended June 30, 2004 and June 30, 2003 was 47% and 45%, respectively. Cost of sales as a percentage of Net sales increased primarily due to the changing channel mix toward the Retail channel. Our Retail channel contributed approximately 69% of our net sales in the six months ended June 30, 2004, compared to 62% in the six months ended June 30, 2003. The Retail channel mix affects the percentage of Cost of sales to Net sales as we are selling into the Retail channel at wholesale prices versus the full MSRP that we receive in the Direct channel. Our Domestic Cost of sales increased to $93.3 million for the six months ended June 30, 2004 as compared to $64.8 million for the six months ended June 30, 2003, an increase of $28.5 million, or 44%. Our International Cost of sales increased to $57.6 million for the six months ended June 30, 2004 as compared to $56.0 million for the six months ended June 30, 2003, an increase of $1.6 million, or 3%, excluding eliminations for sales from the International segment to the Domestic segment.

Selling Expenses. Selling expenses increased to $66.6 million for the six months ended June 30, 2004 as compared to $49.1 million for the six months ended June 30, 2003, an increase of $17.5 million, or 36%. Selling expenses as a percentage of Net sales was 22% during the six months ended June 30, 2004 and the six months ended June 30, 2003. The increase in the dollar amount of

Selling expenses was due to additional spending on advertising, sales compensation and point of purchase materials. Selling expenses as a percentage of Net sales are affected by our channel sales mix and the types of advertising and promotions run during the period.

General and Administrative and Other. General and administrative and other expenses increased to $32.1 million for the six months ended June 30, 2004 as compared to $21.6 million for the six months ended June 30, 2003, an increase of $10.5 million, or 49%. The increase was due to additional spending on corporate overhead expenses, including information technology and professional services. General and administrative expenses for the six months ended June 30, 2004 included approximately $1.4 million in costs associated with our implementation of the requirements of Sarbanes-Oxley Section 404.

Certain stock options granted during the year prior to the initial public offering have exercise prices that are less than the deemed market value of the underlying common stock at the date of grant. We recorded $3.0 million of compensation expense included in General and administrative expenses in the accompanying Condensed Consolidated Statements of Income for the six months ended June 30, 2004.

Loss on Extinguishment of Debt. On January 23, 2004, we redeemed an aggregate principal amount of $52.5 million of the outstanding 10 1/4% Senior Subordinated Notes due 2010 issued by the Company's subsidiaries Tempur-Pedic, Inc. and Tempur Production USA, Inc. The redemption price was 110.25% of the principal amount plus accrued interest, and the redemption was funded with a portion of the net proceeds of the initial public offering of the Company. We reflected the $5.4 million redemption premium as a Loss on extinguishment of debt, a component of other income (expense), net in the accompanying Condensed Consolidated Statements of Income for the six months ended June 30, 2004.

Interest Expense, Net. Interest expense, net increased to $11.6 million for the six months ended June 30, 2004 as compared to $8.2 million for the six months ended June 30, 2003, an increase of $3.4 million. This increase was due to higher average debt levels. In 2003, we entered into an interest rate cap agreement that effectively capped $60.0 million of our floating-rate debt at an interest rate of 5% plus applicable margin through March 2006. We are required under our existing credit agreements to hedge at least $60.0 million of our floating rate senior term debt.

Income Tax Provision. Our effective tax rate for the six months ended June 30, 2004 was approximately 38.5% as compared to 37.1% for the six months ended June 30, 2003. The increase in our effective tax rate for the six months ended June 30, 2004 was due to an increase in non-deductible compensation expense associated with certain options granted prior to the initial public offering, state income taxes and subpart F type income along with reductions in amount of valuation allowances recorded against foreign net operating losses and an increased benefit from charitable contributions.

Liquidity and Capital Resources

Liquidity

At June 30, 2004, we had working capital of $81.2 million including cash and cash equivalents of $25.1 million as compared to working capital of $55.0 million including $14.2 million in Cash and cash equivalents as of December 31, 2003. The $26.2 million increase in working capital was driven primarily by an increase in accounts receivable, net and cash and cash equivalents.

Our principal sources of funds are cash flows from operations and borrowings under our US and European revolving credit facilities. Our principal uses of funds consist of capital expenditures, payments of principal, and interest on our outstanding debt facilities. Capital expenditures totaled $13.8 million for the six months ended June 30, 2004 and $6.7 million for the six months ended June 30, 2003. We currently expect 2004 capital expenditures to be approximately $28.0 million, including approximately $16.0 million associated with the expansion of our European manufacturing facility.

Effective with the Company's initial public offering on December 18, 2003, the authorized shares of capital stock were increased to 300 million shares of common stock and 10 million shares of preferred stock. All outstanding shares of the Company's Series A convertible preferred stock, Class A common stock, Class B-1 common stock and Class B-1 common stock warrants were converted to Tempur-Pedic International common stock on a one-for-one basis. The Company raised $87.5 million from the initial public offering of 6,250,000 shares of common stock at a price to the public of $14.00 per share, all of which shares were issued and sold by the Company.

The Company received net proceeds, after deducting underwriting discounts and commissions, of $79.0 million, of which $18.7 million was used to pay down the Senior Term A loan in December 2003, and $60.3 million was invested in short-term, investment-grade, interest-bearing instruments. During January 2004, we used the remaining proceeds to repay $52.5 million of Senior

Subordinated Notes. In conjunction with the repayment of the Senior Subordinated Notes, we reflected the $5.4 million redemption premium as a Loss on extinguishment of debt included in Other income (expense), net in the six months ended June 30, 2004. Total offering expenses were approximately $8.6 million, including underwriters' discount.

At June 30, 2004, we had approximately $26.5 million available under our US and European revolving credit facilities.

Our cash flow from operations increased to $29.7 million for the six months ended June 30, 2004 as compared to $23.0 million for the six months ended June 30, 2003, an increase of $6.7 million, or 29%. This increase in operating cash flows was primarily the result of an increase in Net income during the period of $3.0 million, non-cash charges of Stock based compensation of $2.8 million, Deferred income taxes of $2.8 million, and Foreign currency adjustments of $2.9 million, which were offset by operating items of $6.8 million.

Net cash used in investing activities increased to $13.7 million for the six months ended June 30, 2004 as compared to $6.1 million for the six months ended June 30, 2003, an increase of $7.6 million or 125%. Investing activities in the six months ended June 30, 2004 consisted primarily of our expansion of the European manufacturing facility.

Cash flow used by financing activities decreased to $4.7 million for the six months ended June 30, 2004 as compared to $21.9 million for the six months ended June 30, 2003, a decrease of $17.2 million or 79%. This decrease is due primarily to the repayment of our long-term debt and revolving credit facility offset by the use of proceeds from the initial public offering to repay $52.5 million of Senior Subordinated Notes.

Impact of Recently Issued Accounting Pronouncements

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" (FIN 46). FIN 46 requires an entity to consolidate a variable interest entity if it is designated as the primary beneficiary of that entity even if the entity does not have a majority of voting interests. A variable interest entity is generally defined as an entity where its equity is unable to finance its activities or where the owners of the entity lack the risk and rewards of ownership. The provisions of this statement apply at inception for any entity created after January 31, 2003. On October 10, 2003, the FASB issued Staff Position (FSP) FIN 46-6, "Effective Date of FASB Interpretation No. 46, Consolidation of Variable Interest Entities" (the FSP). The FSP defers the effective date of FIN 46 for VIEs created or acquired prior to February 1, 2003 until the end of fiscal periods ending after December 15, 2003. The Company adopted the provision of FIN 46 effective on March 31, 2004 and its adoption did not have an impact on our consolidated financial statements.

Risk Factors

The following risk factors and other information included in this report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be impaired.

We operate in the highly competitive mattress and pillow industries, and if we are unable to compete successfully, we may lose customers and our sales may decline.

Participants in the mattress and pillow industries compete primarily on price, quality, brand name recognition, product availability and product performance. Our premium mattresses compete with a number of different types of mattress alternatives, including standard innerspring mattresses, other foam mattresses, waterbeds, futons, air beds and other air-supported mattresses. These alternative products are sold through a variety of channels, including furniture stores, specialty bedding stores, department stores, mass merchants, wholesale clubs, telemarketing programs, television infomercials and catalogs.

Many of our competitors have greater financial, marketing and manufacturing resources and better brand name recognition than our brand, and sell their products through broader and more established distribution channels. In addition, we believe that a number of companies now offer foam mattress products similar to our visco-elastic foam mattresses and pillows. These competitors or other mattress manufacturers may aggressively pursue the visco-elastic foam mattress market. Any such competition by established manufacturers or new entrants into the market could impair our business, financial condition and operating results by causing our products to lose market share. In addition, should any of our competitors reduce prices on premium mattress products, we may be required to implement price reductions in order to remain competitive, which could significantly impair our liquidity and profitability. The pillow industry is characterized by a large number of competitors, none of which is dominant, but many of which have greater resources than us and greater brand name recognition for their products than us.

We may be unable to effectively manage our growth, which could reduce our liquidity and profitability.

We have grown rapidly, with our net sales increasing from approximately $221.5 million in 2001 to approximately $479.1 million for the year ended December 31, 2003 and to $304.7 million for the six months ended June 30, 2004. Our growth has placed, and will continue to place, a strain on our management, production, product distribution network, information systems and other resources. Our growth may strain these resources to the point where they are no longer adequate to support our operations, which would require us to make significant expenditures in these areas. To manage growth effectively, we must:

- significantly increase the volume of products manufactured at our manufacturing facilities;
- continue to enhance our operational, financial and management systems, including our database management, tracking of inquiries, inventory control and product distribution network; and
- expand, train and manage our employee base.

We may not be able to effectively manage this expansion in any one or more of these areas, and any failure to do so could significantly harm our business, financial condition and operating results.

Our senior management team has not worked together as a group for a significant period of time, and may not be able to effectively manage our business.

Several members of our senior management team have been hired since 2001. As a result, our senior management team has not worked together as a group for a significant period of time. Our senior management team's lack of shared experience could have an adverse effect on its ability to quickly and efficiently respond to problems and effectively manage our business.

We may be unable to sustain growth or profitability, which could impair our ability to service our indebtedness and make investments in our business.

Our ability to service our increased level of indebtedness depends, to a significant extent, on our ability to grow our business while maintaining profitability. We may not be able to sustain growth or profitability on a quarterly or annual basis in future periods. There is a limit to the extent to which we can effectively grow in our current business model and we do not know whether we are at or near that limit. Further, our future growth and profitability will depend upon a number of factors, including without limitation:

- the level of competition in the mattress and pillow industry;
- our ability to continue to successfully execute our strategic initiatives and growth strategy;
- our ability to effectively sell our products through our distribution channels in volumes sufficient to drive growth and leverage our cost structure and advertising spending;
- our ability to continuously improve our products to offer new and enhanced consumer benefits, better quality and reduced costs;
- our ability to maintain efficient, timely and cost-effective production and delivery of our products;
- the efficiency and effectiveness of our advertising campaign and other marketing programs in building product and brand awareness, driving traffic to our distribution channels and increasing sales;
- our ability to successfully identify and respond to emerging trends in the mattress and pillow industry;
- our ability to maintain public association of our brand with premium products, including overcoming any impact on our brand caused by some of our customers seeking to sell our products at a discount to our recommended price;
- the level of consumer acceptance of our products; and
- general economic conditions and consumer confidence.

We may not be successful in executing our growth strategy and even if we achieve our strategic plan, we may not be able to sustain profitability. Failure to successfully execute any material part of our strategic plan or growth strategy could significantly impair our ability to service our indebtedness and make investments in our business.

An increase in our return rates or an inadequacy in our warranty reserves could reduce our liquidity and profitability.

Part of our domestic marketing and advertising strategy in certain domestic channels focuses on providing a 90-day money back guarantee under which customers may return their mattress and obtain a refund of the purchase price. For the three months ended June 30, 2004, in the United States we had approximately $7.2 million in returns for a return rate of approximately 8% of our Net sales in the United States. For the six months ended June 30, 2004, in the United States we had approximately $15.7 million in returns for a return rate of approximately 8% of our Net sales in the United States. As we expand our sales, our return rates may not remain within our historical levels. An increase in return rates could significantly impair our liquidity and profitability. We also currently provide our customers with a limited 20-year warranty on mattresses sold in the United States and a limited 15-year warranty on mattresses sold outside of the United States. However, as we have only been selling mattresses in significant quantities since 1992, and have released new products in recent years, many are fairly early in their product life cycles. Because our products have not been in use by our customers for the full warranty period, we rely on the combination of historical experience and product testing for the development of our estimate for warranty claims. However, our actual level of warranty claims could prove to be greater than the level of warranty claims we estimated based on our products' performance during product testing. If our warranty reserves are not adequate to cover future warranty claims, their inadequacy could reduce our liquidity and profitability if our warranty costs exceed our reserves.

We may face exposure to product liability, which could reduce our liquidity and profitability and reduce consumer confidence in our products.

We face an inherent business risk of exposure to product liability claims if the use of any of our products results in personal injury or property damage. In the event that any of our products prove to be defective, we may be required to recall or redesign those products. We maintain insurance against product liability claims, but such coverage may not continue to be available on terms acceptable to us or be adequate for liabilities actually incurred. A successful claim brought against us in excess of available insurance coverage could impair our liquidity and profitability, and any claim or product recall that results in significant adverse publicity against us, could result in consumers purchasing fewer of our products, which would also reduce our liquidity and profitability.

Regulatory requirements may require costly expenditures and expose us to liability.

Our products and our marketing and advertising programs are and will continue to be subject to regulation in the United States by various federal, state and local regulatory authorities, including the Federal Trade Commission and the U.S. Food and Drug Administration. In addition, other governments and agencies in other jurisdictions regulate the sale and distribution of our products. Compliance with anticipated changes in fire resistance laws may be costly and could impair the performance of our products. The U.S. Consumer Product Safety Commission and various state regulatory agencies are considering new rules relating to fire retardancy standards for the mattress and pillow industry. The State of California plans to adopt new fire retardancy standards effective January 2005 that have yet to be fully defined. Such new rules may increase our costs and impair our manufacturing processes. We are developing product solutions that should allow us to meet the new standards. Because the new standards have not been finally determined, however, our solutions may prove inadequate in enabling us to meet the new standards. We expect that any required product modifications will add cost to our product. Many foreign jurisdictions also regulate fire retardancy standards, and changes to these standards and changes in our products that require compliance with additional standards would raise similar risks.

Our marketing and advertising practices could also become the subject of proceedings before regulatory authorities or the subject of claims by other parties. In addition, we are subject to federal, state and local laws and regulations relating to pollution, environmental protection and occupational health and safety. We may not be in complete compliance with all such requirements at all times. We have made and will continue to make capital and other expenditures to comply with environmental and health and safety requirements. If a release of hazardous substances occurs on or from our properties or any associated offsite disposal location, or if contamination from prior activities is discovered at any of our properties, we may be held liable and the amount of such liability could be material.

Allegations of the possibility of price fixing in the mattress industry could increase our costs or otherwise impair our operations.

Our retail pricing policies are subject to antitrust regulations. If federal or state regulators initiate investigations into our pricing policies, our efforts to respond could force us to divert management resources and incur significant unanticipated costs. If the investigation resulted in a charge that our pricing practices or policies were in violation of applicable antitrust regulations, we could be subject to significant additional costs of defending such charges in a variety of venues and, ultimately, if there were an adjudication that we were in violation of federal, state or other antitrust laws, there could be an imposition of damages for persons injured, as well as injunctive relief. Any requirement that we pay fines or damages could decrease our liquidity and profitability, and any investigation that requires significant management attention or causes us to change our business practices could disrupt our operations, also resulting in a decrease in our liquidity and profitability.

Our product development and enhancements may not be successful, which could reduce our ability to compete and our revenues and profitability.

Our business focuses on mattresses and pillows made with our visco-elastic foam, and we are vulnerable to shifting consumer tastes and demands. Our growth and future success will depend, in part, upon our ability to enhance our existing products and to develop and market new products on a timely basis that respond to customer needs and achieve market acceptance. We may not be successful in developing or marketing enhanced or new products, and such products may not be accepted by the market.

We are subject to risks from our international operations, such as increased costs and the potential absence of intellectual property protection, which could impair our ability to compete and our profitability.

We currently conduct international operations in 15 countries directly and in 45 additional countries through distributors, and we may pursue additional international opportunities. We generated approximately 39% of our Net sales from non-US operations during the six months ended June 30, 2004, and international suppliers provided a significant portion of our manufacturing material during this period. Our international operations are subject to the customary risks of operating in an international environment, including the potential imposition of trade or foreign exchange restrictions, tariff and other tax increases, fluctuations in exchange rates, inflation and unstable political situations, the potential unavailability of intellectual property protection and labor issues.

Because we depend on our significant customers, a decrease or interruption in their business with us would reduce our sales and profitability.

Our top five customers, collectively, accounted for 13% of our Net sales for the three months ended June 30, 2004 and 14% for the six months ended June 30, 2004. Our largest customer, Brookstone Company, Inc., accounted for 4% of our Net sales for the three months ended June 30, 2004 and 5% for the six months ended June 30, 2004. Many of our customer arrangements, including the one with Brookstone, are by purchase order or are terminable at will at the option of either party. A substantial decrease or interruption in business from our significant customers could result in write-offs or in the loss of future business and could reduce our liquidity and profitability.

In the future, retailers may consolidate, undergo restructurings or reorganizations, or realign their affiliations, any of which could decrease the number of stores that carry our products or increase the ownership concentration in the retail industry. Some of these retailers may decide to carry only a limited number of brands of mattress products, which could affect our ability to sell our products to them on favorable terms, if at all. Our loss of significant customers would impair our sales and profitability and impair our business, financial condition and results of operations.

We are subject to the possible loss of our third party distributor arrangements and disruption in product distribution in markets outside the range of our wholly-owned subsidiaries, which would reduce our sales and profitability.

We have third party distributor arrangements in the Asia/Pacific, Middle East and Africa, Eastern Europe, Central and South America, Canada and Mexico markets that are currently outside the range of our wholly-owned subsidiaries. Most of these arrangements provide for exclusive rights for such distributors in a designated territory. If our third party distributors cease distributing our products, sales of our products may decrease because we may not be able to find replacement third party distributors or negotiate arrangements with such replacement third party distributors that are as favorable to us. In addition, under the laws of the applicable countries, we may have difficulty terminating these third party distributor arrangements if we choose to do so.

Our advertising expenditures may not result in increased sales or generate the levels of product and brand name awareness we desire and we may not be able to manage our advertising expenditures on a cost-effective basis.

A significant component of our marketing strategy involves the use of direct marketing to generate sales. Future growth and profitability will depend in part on the effectiveness and efficiency of our advertising expenditures, including our ability to:

- create greater awareness of our products and brand name;
- determine the appropriate creative message and media mix for future advertising expenditures;
- effectively manage advertising costs, including creative and media, to maintain acceptable costs per inquiry, costs per order and operating margins; and
- convert inquiries into actual orders.

Our advertising expenditures may not result in increased sales or generate sufficient levels of product and brand name awareness and we may not be able to manage such advertising expenditures on a cost effective basis.

If we are not able to protect our trade secrets or maintain our trademarks, patents and other intellectual property, we may not be able to prevent competitors from developing similar products or from marketing in a manner that capitalizes on our trademarks, and this loss of a competitive advantage could decrease our profitability and liquidity.

We rely on trade secrets to protect the design, technology and function of our visco-elastic foam and our products. To date, we have not sought United States or international patent protection for our principal product formula and manufacturing processes. Accordingly, we may not be able to prevent others from developing visco-elastic foam and products that are similar to or competitive with our products. Our ability to compete effectively with other companies also depends, to a significant extent, on our ability to maintain the proprietary nature of our owned and licensed intellectual property. We own several patents on aspects of our products and have patent applications pending on other aspects of our products. However, the principal product formula and manufacturing processes for our visco-elastic foam and our products are not patented. We own ten United States patents, and we have nine United States patent applications pending. Further, we own approximately thirty-three foreign patents, and we have approximately sixteen foreign patent applications pending. In addition, we hold approximately ninety-seven trademark registrations worldwide. We own United States and foreign registered trade names and service marks and have applications for the registration of trade names and service marks pending domestically and abroad. We also license certain intellectual property rights from third parties.

Although our trademarks are currently registered in the United States and registered or pending in approximately fifty foreign countries, they could be circumvented, or violate the proprietary rights of others, or we could be prevented from using them if challenged. A challenge to our use of our trademarks could result in a negative ruling regarding our use of our trademarks, their validity or their enforceability, or could prove expensive and time consuming in terms of legal costs and time spent defending against it. Any loss of trademark protection could result in a decrease in sales or cause us to spend additional amounts on marketing, either of which could decrease our liquidity and profitability. In addition, if we incur significant costs defending our trademarks that could also decrease our liquidity and profitability. In addition, we may not have the financial resources necessary to enforce or defend our trademarks. Furthermore, our patents may not provide meaningful protection and patents may never be issued for our pending patent applications. It is also possible that others could bring claims of infringement against us, as our principal product formula and manufacturing processes are not patented, and that any licenses protecting our intellectual property could be terminated. If we were unable to maintain the proprietary nature of our intellectual property and our significant current or proposed products, this loss of a competitive advantage could result in decreased sales or increased operating costs, either of which would decrease our liquidity and profitability.

In addition, the laws of certain foreign countries may not protect our intellectual property rights and confidential information to the same extent as the laws of the United States or the European Union. Third parties, including competitors, may assert intellectual property infringement or invalidity claims against us that could be upheld. Intellectual property litigation, which could result in substantial cost to and diversion of effort by us, may be necessary to protect our trade secrets or proprietary technology or for us to defend against claimed infringement of the rights of others and to determine the scope and validity of others' proprietary rights. We may not prevail in any such litigation, and if we are unsuccessful, we may not be able to obtain any necessary licenses on reasonable terms or at all.

We are subject to fluctuations in the cost of raw materials, and increases in these costs would reduce our liquidity and profitability.

The major raw materials that we purchase for production are polyol, an industrial commodity based on petroleum, and proprietary additives. The price and availability of these raw materials are subject to market conditions affecting supply and demand. Our financial condition or results of operations may be impaired by increases in raw material costs to the extent we are unable to pass those higher costs to our customers.

Loss of suppliers and disruptions in the supply of our raw materials could increase our costs of production and reduce our ability to compete effectively.

We currently obtain all of the materials used to produce our visco-elastic foam from outside sources. We currently acquire almost all of our polyol from two suppliers. If we were unable to obtain polyol from these suppliers, we would have to find replacement suppliers. Any substitute arrangements for polyol might not be on terms as favorable to us. In addition, we purchase proprietary additives from a number of vendors, including one from whom we are obligated to purchase minimum quantities. We may not be able to prevent an interruption of production if any supplier were to discontinue supplying us for any reason. We maintain relatively small supplies of our raw materials on-site, and any disruption in the on-going shipment of supplies to us could interrupt production of our products, which could result in a decrease of our sales, or could cause an increase in our cost of sales, and either of these results could decrease our liquidity and profitability. In addition, we outsource much of the sewing and cutting of our mattress and pillow covers to Poland and the Ukraine. If we were no longer able to outsource this labor, we could source it elsewhere at a higher cost. To the extent we are unable to pass those higher costs to our customers, those costs could reduce our gross profit margin, which could result in a decrease in our liquidity and profitability.

We are subject to fluctuations in exchange rates, which could increase the costs of our products and reduce our ability to sell our products in foreign markets.

Approximately 39% of our Net sales were received or denominated in foreign currency for the three months and six months ended June 30, 2004. As a result, we are exposed to foreign currency exchange rate risk, primarily with respect to changes in value of certain foreign currency denominated assets and liabilities of our Denmark manufacturing operations. Although we have in the past entered into hedging transactions to manage this risk and expect that we will continue to do so in the future, the hedging transactions may not succeed in managing our foreign currency exchange rate risk. See "—Foreign Currency Exposures" in Item 3.

For the purposes of financial reporting, any change in the value of foreign currency against the United States Dollar during a given financial reporting period would result in a foreign exchange gain or loss on the translation of any United States Dollar-denominated debt into such foreign currency. We do not enter into hedging transactions to hedge this risk. Consequently, our reported earnings and financial position debt could fluctuate materially as a result of foreign exchange gains or losses. See "—Foreign Currency Exposures" in Item 3.

We produce all of our products in two manufacturing facilities, and unexpected equipment failures, delays in deliveries or catastrophic loss may lead to production curtailments or shutdowns.

We manufacture all of our products at our two facilities in Aarup, Denmark and Duffield, Virginia. An interruption in production capabilities at these plants as a result of equipment failure could result in our inability to produce our products, which would reduce our sales and earnings for the affected period. In addition, we generally deliver our products only after receiving the order from the customer or the retailer and thus do not hold large inventories. In the event of a stoppage in production at either of our manufacturing facilities, even if only temporary, or if we experience delays as a result of events that are beyond our control, delivery times could be severely affected. For example, our third party carrier could potentially be unable to deliver our products within acceptable time periods due to a labor strike or other disturbance in its business. Any significant delay in deliveries to our customers could lead to increased returns or cancellations and cause us to lose future sales. Any increase in freight charges could increase our costs of doing business and harm our profitability. We have introduced new distribution programs to increase our ability to deliver products on a timely basis, but if we fail to deliver products on a timely basis, we may lose sales which could decrease our liquidity and profitability. Our manufacturing facilities are also subject to the risk of catastrophic loss due to unanticipated events such as fires, explosions or violent weather conditions. We may in the future experience material plant shutdowns or periods of reduced production as a result of equipment failure, delays in deliveries or catastrophic loss.

If we are unable to expand our manufacturing capacity on a timely basis, we may not be able to meet the anticipated demand for our products, and if the cost of building these expansions exceeds our estimates, it may have a material adverse affect on our liquidity. In March 2003, we began construction on an addition to our United States manufacturing facility. Total capital expenditures related to this expansion were $17.9 million for 2003, with an additional $0.8 million during 2004. Additionally, we began construction on an expansion of mattress production capacity in our Denmark manufacturing facility in the first quarter of 2004. Total capital expenditures related to this expansion were $2.4 million for 2003 and we expect total capital expenditures related to that expansion to be approximately $16.0 million in 2004. In May 2003, we engaged a site selection firm to assist us in selecting a location for our third manufacturing facility, which will be located in Albuquerque, New Mexico. If our expansion is delayed, we may not have the manufacturing capacity necessary to meet anticipated future demand for our products. In addition, if our capital expenditures exceed our estimates, our liquidity and profitability could be impaired.

A deterioration in labor relations could disrupt our business operations and increase our costs, which could decrease our liquidity and profitability.

As of June 30, 2004, we had approximately 1,147 full-time employees, with approximately 463 in the United States, 282 in Denmark and 402 in the rest of the world. The employees in Denmark are under a government labor union contract but those in the United States are not. Any significant increase in our labor costs could decrease our liquidity and profitability and any deterioration of employee relations, slowdowns or work stoppages at any of our locations, whether due to union activities, employee turnover or otherwise, could result in a decrease in our net sales or an increase in our costs, either of which could decrease our liquidity and profitability.

The loss of the services of any members of our senior management team could impair our ability to execute our business strategy and as a result, reduce our sales and profitability.

We depend on the continued services of our senior management team. The loss of such key personnel could reduce our ability to execute our business strategy and on our financial condition and results of operations. We do not maintain key-person insurance for members of our senior management team other than Robert B. Trussell, Jr. We may have difficulty replacing members of our senior management team who leave and, therefore, the loss of the services of any of these individuals could harm our business.

Our leverage limits our flexibility and increases our risk of default.

As of June 30, 2004, the book value of our long-term debt was $311.5 million. In addition, as of June 30, 2004, our stockholders' equity was $152.9 million. Our high degree of leverage could have important consequences to our investors, such as:

- limiting our flexibility in planning for, or reacting to, changes in our business and the industries in which we compete and increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain in the future additional financing we may need to fund future working capital expenditures, product development, acquisitions or other corporate requirements;
- requiring the dedication of a substantial portion of our cash flow from operations to the payment of principal and interest on our debt, which will reduce the availability of cash flow to fund working capital, capital expenditures, product development, acquisitions and other corporate requirements; and
- placing us at a competitive disadvantage compared to competitors who are less leveraged and have greater financial and other resources.

In addition, the instruments governing our debt contain financial and other restrictive covenants, which limit our operating flexibility and could prevent us from taking advantage of business opportunities. In addition, our failure to comply with these covenants may result in an event of default. If such event of default is not cured or waived, we may suffer adverse effects on our operations, business or financial condition, including acceleration of our debt.

Our ability to meet our debt obligations and to reduce our indebtedness will depend on our future performance, which depends partly on general economic conditions and financial, business, political and other factors that are beyond our control. We may not be able to continue to generate cash flow from operations at or above current levels and meet our cash interest payments on all of our debt and other liquidity needs. If our cash flow and capital resources are insufficient to allow us to make scheduled payments on the senior subordinated notes or our other debt, we may have to sell assets, seek additional capital or restructure or refinance our debt. We may not be able to pay or refinance our debt on acceptable terms or at all. Our ability to refinance all or a portion of our debt or to obtain additional financing is substantially limited under the terms of the indenture governing the senior subordinated notes and the amended senior credit facilities. Under the terms of our debt instruments, Tempur-Pedic International and its subsidiaries may be able to incur substantial additional indebtedness in the future, which would exacerbate the risks associated with our substantial leverage.

If our business plans change or if general economic, financial or political conditions in any of our markets or competitive practices in our industry change materially from those currently prevailing or from those now anticipated, or if other presently unexpected circumstances arise that have a material effect on the cash flow or profitability of our business, the anticipated cash needs of our business as well as the conclusions as to the adequacy of the available sources could change significantly. Any of these events or circumstances could involve significant additional funding needs in excess of the identified currently available sources, and could require us to raise additional capital to meet those needs. However, our ability to raise additional capital, if necessary, is subject to a variety of additional factors, including the commercial success of our operations, the volatility and demand of the capital and lending markets and the future market prices of our securities.

We are vulnerable to interest rate risk with respect to our debt, which could lead to an increase in interest expense.

We are subject to interest rate risk in connection with our issuance of variable rate debt under our amended senior credit facilities. Interest rate changes could increase the amount of our interest payments and thus, negatively impact our future earnings and cash flows. We estimate that our annual interest expense on the unhedged portion of our floating rate indebtedness would increase by $1.5 million for each 1% increase in interest rates. See "—Interest Rate Risk" in Item 3.

There may not be an active, liquid trading market for the Company's common stock.

The Company completed an initial public offering of its common stock on December 23, 2003. If an active, liquid trading market for its common stock does not develop or is not maintained, holders of the Company's common stock may not be able to sell their shares quickly or at the market price. The initial public offering price of the Company's common stock was determined by negotiation between the Company and representatives of the underwriters based upon a number of factors and may not be indicative of prices that will prevail now that Tempur-Pedic International is a public company. The market price of the Company's common stock may decline, and holders of the Company's common stock may not be able to resell their shares at or above the initial offering price.

The Company's stock price will likely be volatile, our stockholders' investment could decline in value, and we may incur significant costs from class action litigation.

The trading price of the Company's common stock is likely to be volatile and subject to wide price fluctuations in response to various factors, including:

- actual or anticipated variations in our quarterly operating results, including those resulting from seasonal variations in our business;
- introductions or announcements of technological innovations or new products by us or our competitors;
- disputes or other developments relating to proprietary rights, including patents, litigation matters, and our ability to patent our products and technologies;
- changes in our financial estimates by securities analysts;
- conditions or trends in the specialty bedding industry;
- additions or departures of key personnel;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- regulatory developments in the United States and abroad; and
- economic and political factors.

In addition, the stock market in general has experienced significant price and volume fluctuations that have often been unrelated or disproportionate to operating performance. These broad market factors may seriously harm the market price of the Company's common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted. A securities class action suit against us could result in potential liabilities, substantial costs, and the diversion of our management's attention and resources, regardless of the outcome.

Future sales of the Company's common stock may depress its stock price.

The market price of the Company's common stock could decline as a result of sales of substantial amounts of its common stock in the public market, or the perception that these sales could occur. In addition, these factors could make it more difficult for us to raise funds through future offerings of common stock. As of June 30, 2004, there were 97,675,555 shares of the Company's common stock outstanding. All of the 21,562,500 shares of the Company's common stock sold in the initial public offering described above are freely transferable without restriction or further registration under the Securities Act of 1933, except for those shares of the Company's common stock which were purchased by our executive officers, directors, principal stockholders, and some related parties.

In addition, although substantially all of the Company's stockholders signed a 180 day lock-up agreement in connection with our initial public offering, this agreement expired in June 2004, and all of the shares held by these stockholders are available for sale into the market, subject only to applicable securities rules and regulations.

In addition, on December 24, 2003, the Company registered up to 14,982,532 shares of its common stock reserved for issuance upon the exercise of options granted or reserved for grant under its 2002 Stock Option Plan, its 2003 Equity Incentive Plan and its 2003 Employee Stock Purchase Plan on a registration statement on Form S-8. Stockholders can sell these shares in the public market upon issuance, subject to restrictions under the securities laws and any applicable lock-up agreements.

The Company's current principal stockholders own a large percentage of its common stock and could limit other stockholders from influencing corporate decisions.

As of June 30, 2004, our executive officers, directors, current principal stockholders, and their respective affiliates beneficially own, in the aggregate, approximately 69.9% of the Company's outstanding common stock on a diluted basis, after giving effect to the vesting of all unvested options. These stockholders, as a group, are able to control substantially all matters requiring approval by the Company's stockholders, including mergers, sales of assets, the election of all directors, and approval of other significant corporate transactions, in a manner with which other stockholders may not agree or that may not be in the best interest of other stockholders.

Provisions of Delaware law and our charter documents could delay or prevent an acquisition of us, even if the acquisition would be beneficial to our investors.

Provisions of Delaware law and our certificate of incorporation and by-laws could hamper a third party's acquisition of us, or discourage a third party from attempting to acquire control of us. Our investors may not have the opportunity to participate in these transactions. These provisions could also limit the price that investors might be willing to pay in the future for shares of the Company's common stock.

These provisions include:

- our ability to issue preferred stock with rights senior to those of the common stock without any further vote or action by the holders of the Company's common stock;
- the requirements that the Company's stockholders provide advance notice when nominating our directors; and
- the inability of the Company's stockholders to convene a stockholders' meeting without the chairperson of the board, the president, or a majority of the board of directors first calling the meeting.

We do not anticipate paying dividends on our capital stock in the foreseeable future.

In August 2003, in connection with the recapitalization described above, we paid approximately $160.0 million to our equityholders as a return of capital and we do not anticipate paying any dividends in the foreseeable future. We currently intend to retain our future earnings, if any, to fund the development and growth of our business. In addition, the terms of the instruments governing our existing debt and any future debt or credit facility may preclude us from paying any dividends. As a result, capital appreciation, if any, of the Company's common stock will be investors' sole source of gain for the foreseeable future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exposures

Our earnings, as a result of our global operating and financing activities, are exposed to changes in foreign currency exchange rates, which may adversely affect our results of operations and financial position. A sensitivity analysis indicates that if the exchange rate of the United States Dollar to foreign currency at June 30, 2004 increased by 10%, we would incur additional losses of approximately $0.6 million on foreign currency forward contracts outstanding at June 30, 2004. Such losses would be largely offset by gains from the revaluation or settlement of the underlying positions economically hedged. This calculation assumes that each exchange rate would change in the same direction relative to the United States Dollar.

Within the normal course of business, we use derivative financial instruments principally to manage the exposure to changes in the value of certain foreign currency denominated assets and liabilities of our Denmark manufacturing operations. Gains and losses are recognized currently in the results of operations and are generally offset by losses and gains on the underlying assets and liabilities being hedged. Gains and losses on these contracts generally offset losses and gains on our foreign currency receivables and foreign currency debt. We do not hedge the effects of foreign exchange rates fluctuations on the translation of its foreign results of operations or financial position, nor do we hedge exposure related to anticipated transactions.

We do not apply hedge accounting to the foreign currency forward contracts used to offset currency-related changes in the fair value of foreign currency denominated assets and liabilities. These contracts are marked-to-market through earnings at the same time that the exposed assets and liabilities are remeasured through earnings. Our currency forward contracts are denominated in United States Dollars, British Pound Sterling and Japanese Yen, each against the Danish Krone.

Interest Rate Risk

We are exposed to changes in interest rates. All of our indebtedness under our amended senior credit facilities is variable rate debt. Interest rate changes therefore generally do not affect the market value of such debt but do impact the amount of our interest payments and therefore, our future earnings and cash flows, assuming other factors are held constant. On June 30, 2004, we had variable rate debt of approximately $212.0 million. Holding other variables constant including levels of indebtedness, a one hundred basis point increase in interest rates on our variable rate debt would have an estimated impact on income before income taxes for the next year of approximately $2.1 million. We are required under the terms of our amended senior credit facilities to have at least $60.0 million of our total indebtedness subject to either a fixed interest rate or interest rate protection for a period of not less than three years within 60 days from the date of the closing of the recapitalization.

In January 2003, we paid a premium to purchase two three-year interest rate caps for the purpose of protecting $60.0 million of the existing variable interest rate debt outstanding, at any given time, against LIBOR rates rising above 5%. Under the terms of the interest rate caps, we have paid a premium to receive payments based on the difference between 3-month LIBOR and 5% during any period in which the 3-month LIBOR rate exceeds 5%. The interest rate caps settle on the last day of March, June, September and December until expiration.

As a result of entering into the interest rate caps, we have mitigated our exposure to interest rate fluctuations above the predetermined level. As the interest payments on long-term debt are based on 3-month LIBOR and we receive a payment based on the difference between the set ceiling (5%) and 3-month LIBOR from the interest rate cap counter-party, we have eliminated any impact to rising interest rates above the stated ceiling, for an amount equal to $60.0 million of our total debt outstanding.

The fair value carrying amount of these instruments was $0.2 million at June 30, 2004 and $0.7 million at December 31, 2003, which is recorded as follows:

($ in millions)	June 30, 2004	December 31, 2003
Foreign exchange receivable	$ 0.1	$ 0.5
Interest rate caps	0.1	0.2
Total	$ 0.2	$ 0.7

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, of the effectiveness of our disclosure controls and procedures, as defined in the rules promulgated under the Securities and Exchange Act of 1934, or the Exchange Act, as of the end of the period covered by this report. Based on that evaluation, our management, including the CEO and CFO, concluded that our disclosure controls and procedures were effective as of June 30, 2004 to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. During our last fiscal quarter, there were no changes in our internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are involved in various legal proceedings incident to the ordinary course of our business. We believe that the outcome of all pending legal proceedings in the aggregate will not have a material adverse effect on our business, financial condition, liquidity or operating results.

ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

Items 2(a) through (e) are not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The annual meeting of stockholders was held on June 22, 2004. Proposals 1 and 2 were approved. The results are as follows:

Proposal 1

The following directors were elected at the meeting to serve a one-year term as directors:

	For	Authority Withheld
Jeffrey S. Barber	86,970,706	20,101
Francis A. Doyle	86,975,081	15,726
Tully M. Friedman	86,659,592	331,215
Nancy F. Koehn	86,975,081	15,726
Christopher A. Masto	86,970,781	20,026
P. Andrews McLane	86,970,781	20,026
Robert B. Trussell, Jr.	86,975,081	15,726

There were no broker non-votes on this matter.

Proposal 2

Ratification of appointment of Ernst & Young LLP as the Company's independent auditors for fiscal year 2004.

For	Against	Abstained
86,720,902	2,548	267,357

There were no broker non-votes on this matter.

The proposals above are described in detail in the Company's definitive proxy statement dated April 28, 2004, for the Annual Meeting of Stockholders held on June 22, 2004.

ITEM 5. OTHER INFORMATION

(a) Not applicable

(b) Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

31.1 Certification of Chief Executive Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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32.1 * Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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* This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, nor shall it be deemed incorporated by reference in any filings under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

(b) During the fiscal quarter ended June 30, 2004, we filed the following Current Reports on Form 8-K:

- Form 8-K dated April 1, 2004 (Items 7 and 9) furnishing a press release clarifying statements regarding compliance with certain credit facility covenants.
- Form 8-K dated April 22, 2004 (Items 5, 9 and 12) furnishing a press release announcing our financial results for the quarter ended March 31, 2004 and filing certain information contained therein under the heading “Quarterly Financial Data” relating to the effect of stock-based compensation and loss on debt extinguishment for each of the fiscal quarters in 2003.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TEMPUR-PEDIC INTERNATIONAL INC.
(Registrant)

Date: August 13, 2004	By:	/s/ Dale E. Williams
		Dale E. Williams Senior Vice President, Chief Financial Officer, Secretary and Treasurer (Principal Financial Officer and Duly Authorized Officer)

Exhibit 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Robert B. Trussell, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tempur-Pedic International Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2004

/s/ Robert B. Trussell, Jr.

President and Chief Executive Officer

Exhibit 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Dale E. Williams, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tempur-Pedic International Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 13, 2004

/s/ Dale E. Williams

Senior Vice President, Chief Financial Officer, Secretary and Treasurer

Exhibit 32.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Each of the undersigned hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, in his capacity as an officer of Tempur-Pedic International Inc. (the "Company"), that, to his knowledge, the Quarterly Report of the Company on Form 10-Q for the period ended June 30, 2004, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of the Company. This written statement is being furnished to the Securities and Exchange Commission as an exhibit to such Form 10-Q. A signed original of this statement has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Date: August 13, 2004

By: /s/ Robert B. Trussell, Jr.

Robert B. Trussell, Jr.
President and Chief Executive Officer

Date: August 13, 2004

By: /s/ Dale E. Williams

Dale E. Williams
Senior Vice President, Chief Financial Officer,
Secretary and Treasurer